S. HRG. 112–409

CONTINUED OVERSIGHT OF THE IMPLEMENTATION OF THE WALL STREET REFORM ACT

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

ON

EXAMINING THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT ON THE FINANCIAL REGULATORY FRAMEWORK, AND THE IMPACT OF THE FINANCIAL CRISIS ON AMERICAN CONSUMERS, INVESTORS AND THE OVERALL ECONOMY

DECEMBER 6, 2011

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C O N T E N T S

TUESDAY, DECEMBER 6, 2011

WITNESSES

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

CONTINUED OVERSIGHT OF THE IMPLEMENTATION OF THE WALL STREET REFORM ACT

TUESDAY, DECEMBER 6, 2011

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:04 a.m. in room SD–538, Dirksen Senate Office Building, Hon. Tim Johnson, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN TIM JOHNSON

Chairman JOHNSON. Good morning. I call this hearing to order.

Today this Committee continues its oversight of the implementation of the Wall Street Reform Act. Since the last implementation hearing in July, there have been significant developments regarding rule proposals, rule finalizations, and more broadly, additional concerns about the impact of the crisis in Europe.

We do not have to imagine a far-off crisis to be reminded of why we passed Wall Street reform. The current situation in Europe underscores the importance of implementing new rules that enhance supervision of large, complex financial firms and the financial system as a whole, reduce risk in the marketplace, and support financial stability.

Over the past 18 months, since the passage of the Wall Street reform bill, much progress has been made. Agencies and offices have been merged or created, and some very important rules, including the rules for orderly liquidation and living wills, have been finalized. The Consumer Financial Protection Bureau has opened its doors and is doing excellent work on projects like simplifying mortgage and student loan forms through its "Know Before You Owe" initiative. But work remains to be done.

Some of the most complex rulemakings of the Wall Street Reform Act are the ones still under consideration: the Qualified Residential Mortgage determination otherwise known as QRM, the Volcker Rule, provisions to enhance supervision of nonbank financial and bank-holding companies, and the rules under which nonbank financial firms will be designated "systemically important." I want timely resolution of these critical, outstanding rulemakings, and I am looking forward to hearing about the next steps for these rules from our panelists today.

I recognize that these rulemakings are difficult, but this is the time when tough decisions have to be made by our regulators.

While our economy is starting to show signs of recovery from the financial crisis, the ongoing turmoil in Europe is a stark reminder that we must continue to monitor threats to financial stability. The Wall Street Reform law gave our regulators new tools to better address potential threats, to create well-functioning markets while also reducing systemic risks, and to improve supervision. But until the new rules are implemented, our financial system and our economy remain vulnerable to these threats.

I want to thank the regulators before us today for their tireless work over the last 18 months continuing implementation of this important law. In addition, you are all dealing with many challenges, including funding constraints, the bankruptcy of MF Global, and other supervisory issues that the institutions you regulate face as the economy continues to recover from the financial crisis. I have no doubt that you and all your staffs will keep up the important work.

Senator Shelby, your opening statement.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Mr. Chairman. Welcome to the Committee, all of you.

Today our financial regulators will give us a progress report on their implementation of the Dodd-Frank Act. When Dodd-Frank was passed, the American people were promised that financial regulators would have all the tools and powers that they need to properly regulate financial institutions and to protect investors and consumers.

Unfortunately for the American people, more powers and more tools cannot help when regulators fail to do their jobs. This lesson is vividly demonstrated by the Commodity Futures Trading Commission's failed regulation of MF Global. The CFTC's most basic responsibility is to ensure that customers are protected when a firm fails, yet 37 days have passed since MF Global filed for bankruptcy and more than $1 billion in customer funds are still missing and unaccounted for.

It is unclear how much longer customers must wait while a bewildered CFTC searches for their money. Holding the CFTC accountable for its regulatory failures will not be an easy task. Already Chairman Gensler has been evading questions about his role in the regulation of MF Global. Prior to the firm's bankruptcy, it appears that Chairman Gensler had contacts with MF Global and its CEO, Jon Corzine, concerning the CFTC's regulation of the firm. But when he was called to account for the firm's bankruptcy and the missing customer funds, Chairman Gensler decided that he needed to recuse himself from matters dealing with MF Global. The victims of MF Global I believe deserve better.

Accordingly, I have asked the CFTC's Inspector General to examine the Commission's oversight and regulation of MF Global. I have also asked him to determine whether Chairman Gensler's recusal was appropriate and whether Mr. Gensler should have recused himself much earlier in the process. In the absence of a Committee investigation, the IG's examination will help determine whether MF Global received special consideration by the CFTC.

Although the CFTC's failures have received the most attention, our other financial regulators have had their own difficulties. Over the last year, it appears that the Securities and Exchange Commission has been operating as a no-doc regulator in its rulemakings and enforcement actions.

First, the SEC's proxy access rule was struck down as arbitrary and capricious by the D.C. Circuit because the SEC failed to properly conduct economic analysis before issuing the rule. Just last week, a Federal court refused to endorse a major SEC settlement because the SEC failed to provide sufficient evidence that the settlement was in the public interest. Meanwhile, banking regulators have struggled to effectively implement several key rules. Most importantly, the proposal to implement the Volcker Rule has been marred by misconduct, ambiguity, and interagency discord. Drafts of the proposed rule were leaked to the press, prompting Inspector General inquiries into whether agency personnel violated confidentiality rules.

When regulators finally issued a proposed rule, it came in the form of a 298-page concept proposal with over 1,300 questions. We all agree that banks should not be allowed to gamble with taxpayer-guaranteed deposits, yet the ambiguity in the proposed rule threatens to make compliance costly and difficult, especially for smaller banks.

Further, the CFTC has not signed on to the Volcker proposal and may opt to draft its own rule. The Financial Stability Oversight Council was established to ensure that regulators properly coordinate their rulemakings. I hope to hear today why the Council was unable to secure agreement on the Volcker Rule. More than a year has passed now since the enactment of Dodd-Frank, and it is now evident that it has not lived up to its promises. In fact, it has exacerbated many problems by granting large bureaucracies greater powers while further insulating them from congressional oversight.

For much too long, we have sacrificed the voice of the people on the altar of regulatory independence. What we are left with are massive bureaucracies insulated from the people they are supposed to be protecting and unaccountable for their actions. This week, the President is calling for the confirmation of the Director of the Bureau of Consumer Financial Protection. This massive new bureaucracy was designed by the drafters of Dodd-Frank to be virtually unaccountable to the American people. Before we spend hundreds of millions of dollars on a new Federal Government agency, I believe we should ensure that it can be held accountable for its actions. Therefore, I and 44 of my Republican colleagues have informed the President that we will not consider the nomination of anyone to be the first Director until the Bureau is made accountable to the American people and we have had some legislative structural changes.

The authors of Dodd-Frank believed that more Government was better, more regulators, more rules, more regulations, and more bureaucrats with more independence empowered to make choices for others. We were told that we could expect great things. The first year has shown that little has changed. Dodd-Frank contains many flaws, but the failure to improve the accountability of our financial regulators may be its greatest shortcoming.

Thank you.

Chairman JOHNSON. Thank you, Senator Shelby.

Are there any other Members who wish to make a brief opening statement?

Senator MENENDEZ. Mr. Chairman?

Chairman JOHNSON. Yes, Senator Menendez.

STATEMENT OF SENATOR ROBERT MENENDEZ

Senator MENENDEZ. Thank you, Mr. Chairman, for holding the hearing. Thank you to all of our witnesses.

I was proud to support the Wall Street Reform and Consumer Protection Act. If implemented correctly, I believe it will result in better loan underwriting, better protections for consumers, better oversight of risks that affect the stability of the financial system, greater transparency in derivatives, and progress toward ending too big to fail so that the decisions of those who at large institutions ultimately became the collective risks of the entire country. I do not want to relive 2008 again.

So it is important to take the time to get the rules right, but it is also important to know that progress is being made, so I look forward to hearing from the witnesses.

And, finally, with respect to the Consumer Financial Protection Bureau that I also advocated for, regardless of what you think of the new consumer watchdog, it is time for the Senate to understand something about majority rule. A majority, a bipartisan majority, of the U.S. Senate voted for the Dodd-Frank Wall Street reform law. Part of that law is the Consumer Financial Protection Bureau. It needs a Director. It needs a Director to ultimately level the playing field. This nominee has been highly commended by both the private sector and the consumer sector. But without having a Director, there are a whole host of rules that cannot be written, which only perpetuates an uneven playing field where community banks and credit unions have to abide by regulations and nonbank lenders do not, which is not fair to consumers or the industry members who play by the rules.

So it is time to allow for an up-or-down vote on Richard Cordray and to get us moving forward on the proposition that a bipartisan majority of the U.S. Senate representing the country should be able to have its day and move forward.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Brown.

STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Mr. Chairman. I want to echo the words from my colleague Senator Menendez about the importance of the Consumer Financial Protection Bureau. I am, I think, the only one on the panel who knows Attorney General Cordray personally fairly well, and as Senator Menendez said, he has support in the public sector and private sector from Republicans and Democrats, including his successor as Attorney General. Former Senator DeWine is supporting him, and it is the only time—I have mentioned this to the Committee before and talked to Chairman Johnson about it, too, and to Ranking Member Shelby. This is the only time, the Senate historian said, in American history where one po-

litical party has blocked a nominee because they do not like the makeup of the agency, they do not agree with the existence of the agency, so they block the administrator for the agency. And that just does not make sense, and it is unprecedented, as I said, and it does not serve this country. And we know that banks are treated differently from nonbanks as a result. That does not serve anybody's interest well. It does not protect the public, and it is just the kind of overreach that we have seen far too often around here. And I am sorry to say that, but I think that, again, speaks volumes about why we need to do what we need to do.

Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you all. I want to remind my colleagues that the record will be open for the next 7 days for opening statements and any other material you would like to submit.

I would like to welcome our witnesses back to the Banking Committee, and we will keep the introductions brief.

The Honorable Neal S. Wolin is Deputy Secretary of the U.S. Department of the Treasury.

The Honorable Dan Tarullo is currently serving as a member of the Board of Governors of the Federal Reserve System.

The Honorable Mary Schapiro is Chairman of the U.S. Securities and Exchange Commission.

The Honorable Gary Gensler is the Chairman of the Commodity Futures Trading Commission.

The Honorable Marty Gruenberg is the Acting Chair of the Federal Deposit Insurance Corporation.

Mr. John Walsh is the Acting Comptroller of the Currency of the Office of the Comptroller of the Currency.

I thank all of you for being here today. I would like to ask the witnesses to please keep your remarks to 5 minutes. Your full written statements will be included in the hearing record.

Secretary Wolin, you may begin your testimony.

STATEMENT OF NEAL S. WOLIN, DEPUTY SECRETARY, DEPARTMENT OF THE TREASURY

Mr. WOLIN. Thank you, Chairman Johnson, Ranking Member Shelby, and Members of the Committee, for the opportunity to appear today.

Congress passed financial reform 18 months ago in the aftermath of the financial that cost this country 9 million jobs, trillions of dollars, and countless opportunities. Today our country's foremost challenge is helping the millions of Americans who lost their jobs in the recession find new employment. Nearly 3 million private sector jobs have been created within the last 2 years, but our economy is not creating new jobs fast enough.

The President has laid out a set of ideas that together would create nearly 2 million jobs, and we hope Congress will move forward with them. But at the same time, our current economic challenges only increase our commitment to implementing financial system fully, quickly, and carefully.

Those reforms address the flaws and failures in the financial system that led to the crisis from which our economy and our country is still recovering. While we believe providing certainty as soon as possible is important, Treasury and the independent regulators are

committed to balancing speed with time for broad public engagement and debate, time for coordination amongst U.S. regulators and our international counterparts to help achieve a level playing field, and time for analyses of costs and benefits to help ensure rules that build a stronger, more resilient financial system within placing unnecessary burdens on industry.

Since reform was passed last July, we have made substantial progress while abiding by these principles. Financial regulators have now publicly proposed or finalized nearly all the major rules relating to the core elements of reform. The ultimate shape of both individual rules and reform as a whole is becoming clearer by the week.

Treasury has also made substantial progress standing up new institutions to help ensure our financial system is stronger and more resilient going forward. The members of the Financial Stability Oversight Council have been meeting regularly for over a year. The Office of Financial Research is providing it with critical data and analytical support. And the Federal Insurance Office has begun carrying out its mission to monitor the insurance industry.

Treasury has also been responsible for standing up the Consumer Financial Protection Bureau. President Obama has nominated Richard Cordray, an outstanding advocate for American consumers, to serve as its first Director, but his confirmation has not moved forward. Without a Director, the CFPB is unable to exercise its full authority, and as a result, our economy remains vulnerable to some of the same regulatory gaps that contributed to the financial crisis, and consumers continue to lack common-sense protections.

The CFPB's limited authority affects the financial security of tens of millions of American families who rely on nonbank institutions for financial products and services. Until the Director is in place, the CFPB cannot supervise nonbanks that do business with Americans every day in the mortgage, payday, and private student lending markets, among others.

We have a responsibility to make sure the CFPB can exercise its full authority to protect servicemembers, students, seniors, and the American people as a whole from the types of unfair and predatory practices that proliferate in the run-up to the financial crisis.

Full implementation of the Dodd-Frank Act is critical for protecting Americans not only from poor consumer protections, but also from the excess risk and fragmented oversight that played such important roles in bringing about the crisis.

In implementing reform, our goal is to build a financial system that is not prone to panic and collapse, that helps Americans save for retirement and borrow to finance an education or a home without experiencing deception or abuse, and that helps businesses finance growth and investment and strengthens our economy.

We appreciate the leadership and support of this Committee throughout the reform process, and we look forward to working with Congress as we move forward toward this common goal.

Thank you.

Chairman JOHNSON. Thank you.

Mr. Tarullo, please proceed.

STATEMENT OF DANIEL K. TARULLO, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. TARULLO. Thank you, Mr. Chairman, Senator Shelby, and Members of the Committee. There are a lot of witnesses and a lot of Senators, so let me just make two introductory points.

First, I think you all recognize that there is a bit of tension between the various goals that we all have in trying to implement a very complicated piece of legislation. We want to get it right. We want to have a process that is very considered. We want to have a very open and transparent process. And then we want to get it all done quickly. And it is not going to be possible to get everything done quickly if the fairness, the openness, the transparency, and the considered quality of the deliberations are not going to be adhered to. I think, though, we are making considerable progress, and although a few of the statutory deadlines have not been met, I think we are well on our way to getting the major pieces of Dodd-Frank into place.

The second point I would like to make will come as no surprise to many Members of the Committee since I try not to miss any opportunity to re-emphasize the importance of capital in our prudential regulatory system. Dodd-Frank, of course, addressed capital in several particulars. It did not provide a comprehensive approach to capital. But what we have tried to do is to incorporate the elements of capital regulation set forth in Dodd-Frank into an overall integrated approach to capital regulation that tries to take account of the shortcomings of that system prior to the crisis. I think the shortcomings were basically three:

One, both the quality and quantity of capital in individual institutions was lower than it needed to be before the crisis.

Two, there was only a micro-prudential, that is, a firm-by-firm approach to looking at capital rather than looking at how firms and the stability of firms affected the system as a whole in a macroprudential fashion.

And, third, capital assessment was too static. We tended to take snapshots of how capital looked at a particular moment rather than the dynamic perspective that suggests or shows what capital ratios could be like if bad things occur.

What we have done is, in coordination with our banking colleagues here and abroad, to negotiate and now get ready to implement a set of enhancements to both the quality and quantity of capital for individual firms. That is, I think, helped from my perspective a lot by the Collins amendment to Dodd-Frank because since Collins puts a floor under the amount of capital that is required for a firm, it allays a lot of the concerns that I had and I think some Members of the Committee had that Basel II might allow capital to drift too low.

Second, with respect to macroprudential capital regulation, we are moving forward with a set of enhanced prudential standards for the largest, most systemically important institutions, including enhanced capital standards.

And, third, with respect to that snapshot dynamism issue, Dodd-Frank, as you know, calls for stress tests for larger U.S. institutions. The full Dodd-Frank provisions and the full Dodd-Frank stress test approach will be implemented next year. But in the be-

ginning of this year and now starting again for the beginning of 2012, we have been running and will be running stress tests on our largest institutions as part of our annual capital review.

I would just close by saying that I think there is a lot going on in Dodd-Frank. We are making progress. But, again, I just want to remind everybody of the centrality of capital regulation to the safety and soundness of our financial system.

Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you.

Chairman Schapiro, please proceed.

STATEMENT OF MARY L. SCHAPIRO, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Ms. SCHAPIRO. Chairman Johnson, Ranking Member Shelby, and Members of the Committee, thank you for inviting me to testify on the Securities and Exchange Commission's ongoing implementation of the Dodd-Frank Act.

The Dodd-Frank Act significantly changes the SEC's regulatory landscape. It brings hedge fund and other private fund advisers under the regulatory umbrella, creates a new whistleblower program, establishes an entirely new regime for the over-the-counter derivatives market, enhances the SEC's authority over credit rating agencies and clearing agencies, and heightens regulation of asset-backed securities.

In the months since the Act's passage, we have made significant progress in our efforts to meet these broad new responsibilities. Of the more than 90 provisions in the Act that require SEC rulemaking, we have proposed or adopted rules for over three-fourths of them. In addition, we have finalized 12 studies and reports required by the Act.

As I have noted in my prior testimony before this Committee, our rulemaking efforts are informed by a substantial outreach effort. SEC Commissioners and staff have participated in scores of interagency and working group meetings; conducted seven public roundtables; met with hundreds of interested groups and individuals, including investors, academics, and industry participants; and received, reviewed, and considered thousands of public comments.

All of these efforts, in addition to congressional input and robust Commission debate, are helping us write rules that effectively protect investors and the financial system without imposing undue burdens on market participants. My written statement underscores in detail the breadth and complexity of our Dodd-Frank rulemaking activities. However, I would like to emphasize a few of our recent actions.

Just over a month ago, the Commission adopted a new rule that requires hedge fund and other private fund advisers registered with the Commission to report systemic risk information. This rule, adopted jointly with the CFTC and in heavy consultation with FSOC, will dovetail with the enhanced private fund reporting adopted earlier this year and is scaled to the size of the funds.

In August, our final rules became effective establishing the whistleblower program mandated by the Act. Since then, the Commission has received hundreds of tips through the program from individuals all over the country and in many parts of the world. We

already are reaping the early benefits of the whistleblower program through active and promising investigations utilizing crucial whistleblower information, some of which we expect will lead to rewards in the near future.

With regard to credit rating agencies, the Commission proposed rules intended to strengthen the integrity of credit ratings by, among other things, improving their transparency. In addition, the Commission received public comment to inform its upcoming study on the feasibility of establishing a system in which a public or private utility or self-regulatory organization would assign NRSROs to determine the credit ratings for structured finance products.

To implement the new oversight regime for the over-the-counter derivatives market, the Commission proposed rules in 13 areas required by Title VII. In the coming months, we expect to propose our last Title VII rules regarding capital margins, segregation, and recordkeeping requirements for security-based swap dealers and swap participants.

Along with our fellow regulators, the Commission also proposed rules to implement the Volcker Rule and to provide for increased regulation of financial market utilities and financial institutions that engage in payment, clearing, and settlement activities that are designated as systemically important.

In addition to these areas, the Commission proposed rules affecting the registration of municipal advisers, asset-based securities, and corporate governance.

In the new few months, we expect to adopt additional rules regarding specialized disclosure provisions related to conflict minerals, coal or other mine safety, and payments by resource extraction issuers to foreign or U.S. Government entities. In addition, we intend to address the relevant international issues of Title VII holistically in a single proposal, and we expect to seek public comment on an implementation plan for all of the key rules under Title VII with the goal of ensuring the rules take effect in a logical, progressive, and efficient manner that minimizes unnecessary disruption and costs to the markets.

The SEC has made tremendous progress, but the provisions of the Dodd-Frank Act vastly expand our responsibilities and will require additional resources to fully implement the law. While we seek to use existing resources as efficiently as possible, the new responsibilities assigned to us are so significant they cannot be achieved solely by wringing efficiencies out of our existing budget. Attempting to do so will severely hamper our ability to meet both new and existing responsibilities.

I would note that, regardless of the amount appropriated to the SEC, our budget will be fully offset by the fees we collect and will have no impact on the Nation's budget deficit.

Thank you for inviting me to share with you our progress to date and our plans going forward. I look forward to answering your questions.

Chairman JOHNSON. Thank you.

Chairman Gensler, please proceed.

STATEMENT OF GARY GENSLER, CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION; ACCOMPANIED BY JILL E. SOMMERS, COMMISSIONER, COMMODITY FUTURES TRADING COMMISSION

Mr. GENSLER. Good morning, Chairman Johnson, Ranking Member Shelby, and Members of the Committee. I am glad to be here with fellow regulators and also with CFTC Commissioner Jill Sommers.

Three years ago, both the financial system and the financial regulatory system failed. More than eight million jobs were lost, and today, millions of Americans continue to struggle. Swaps played a central role in the crisis. Swaps, so important for managing and lowering risk for end users, also concentrated risk in the financial system, and in response, Congress and the President came together and enacted the historic Dodd-Frank Act.

The CFTC is working to complete the Dodd-Frank rules thoughtfully, not against a clock, and though Congress gave us 1 year to complete the task, we will take more time, as is appropriate, I believe. The agency has benefited from significant public input, including more than 25,000 comment letters, 1,100 meetings, and we have conducted 14 public roundtables, and yesterday we announced two more public roundtables, and no doubt we will get benefit from even more beyond that.

The Commission has substantially completed the proposal phase of the rule writing and this summer turned the corner and began finalizing rules, after asking people to comment on the whole mosaic at one time. And we have finished 20 rules and have a full schedule of meetings well into next year.

Each of our final rules have benefited from careful considerations of cost and benefits and we ask the public to continue to give us advice in this area.

Mentioning just a few areas that we finalized: large trader reporting, so for the first time we know what the large traders are doing in physical commodities, registration of the data repositories themselves; aggregate position limits; risk management for the clearinghouses, these bodies that are going to have significant more transactions in them. We also finished rules giving the Commission more authority to prosecute wrongdoers who recklessly manipulate markets, giving us authorities that the SEC has had for years.

And yesterday, we completed a rule first proposed in October 2010 to enhance customer protection regarding investment of their funds. This rule brings customers back to the protections they had prior to exemptions granted by the Commission between 2000 and 2005 and it will prevent investment of customer funds in foreign debt as well as lending customer money within the firm, which is called intercompany or in-house repurchase agreements. I have consistently felt that the CFTC needed to strengthen customer fund protection and I am pleased that the Commission acted yesterday in this regard.

The Commission is also looking to soon finish rules on segregation for cleared swaps. These are cleared swaps. But segregation of funds, both in the futures market and in the swaps market, is the core foundation of customer protection and our agency is looking across the board, the audit regimes, the examination regimes, the

custodial regimes, the working relationships with the self-regulatory organizations, to see what can we do more to enhance these protections and protect customers.

Moving forward, we are working to finish key transparency rules, including the specific data to be reported to regulators, so all of us at this table can have more information and the public can have more information in what is called real time reporting.

As mandated by Dodd-Frank, the CFTC is working closely with the SEC on further definitions of swap dealer and swap and I hope that we can get these done shortly.

An important matter to all of us is nonfinancial end users have a choice on whether or not to use central clearing. This was Congress's mandate. But I think consistent with that intent, as well, the CFTC's margin proposal states that nonfinancial end users will not be required to post margin on uncleared swaps, and the CFTC is dedicated to maintaining the ability of end users to hedge risk without being pulled into those margin and clearing regimes.

Now, as the CFTC finalizes rules, I will say we do need more resources. We are just over 700 staff members. That is about 10 percent more than we were in the 1990s at our peak, and since then, the futures market has grown dramatically, about fivefold. And in addition, we are asked to oversee this complex and very large $300 trillion notional amount swaps market. We rely a lot on self-regulatory organizations, but I dare say we probably need some more funding so that the Nation can be assured we can actually oversee the futures and swaps markets and enforce the rules to promote the transparency and protect the public.

Furthermore, as many Members have mentioned, the current debt crisis in Europe has put a stark reminder of the need for us to move forward, complete reform, and adequately resource the agency.

I thank you.

Chairman JOHNSON. Thank you.

Chairman Gruenberg, please proceed.

STATEMENT OF MARTIN J. GRUENBERG, ACTING CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. GRUENBERG. Thank you, Chairman Johnson, Ranking Member Shelby, and Members of the Committee. Thank you for the opportunity to testify on the FDIC's implementation of the Dodd-Frank Act.

The FDIC has made substantial progress on implementing the requirements of the Act, especially in the two primary areas where we have principal rulemaking responsibility, deposit insurance reforms and orderly liquidation authority.

Regarding deposit insurance, the FDIC has issued final rules that permanently increase the standard coverage limit to $250,000 and temporarily provide unlimited deposit insurance for non-interest bearing transaction accounts.

In addition, the FDIC adopted a final rule that redefines the deposit insurance assessment base from domestic deposits to assets. The new definition reduces the share of assessments paid by community banks as a group compared to the largest institutions, bet-

ter reflecting each group's share of industry assets. As a result of this new rule, second quarter 2011 assessments for banks with less than $10 billion in assets were about a third lower in aggregate than first quarter assessments, even though the overall amount of assessment revenue collected remained about the same.

The FDIC also has substantial flexibility under the Act to manage the Deposit Insurance Fund. The FDIC's Fund Management Plan is designed to maintain a positive fund balance, even during a banking crisis, while preserving steady and predictable assessment rates through economic and credit cycles.

Regarding orderly liquidation authority, a fundamental goal of the Act is to promote financial stability by improving regulators' ability to deal with systemic risk and the challenges posed by systemically important financial institutions. In July, the FDIC issued a final rule implementing the FDIC's orderly liquidation authority. The rule defines the way creditors will be treated and how claims will be resolved in an FDIC receivership. Many aspects of the rule are similar to the rules in bankruptcy. Shareholders and creditors in receivership will be exposed to losses under the statutory priority of claims. The rule, however, will allow continuity of critical operations, both to prevent the financial system from freezing up and to maximize the value recovered from the assets of a failed SIFI, or systemically important financial institution.

The FDIC also has adopted two rules regarding resolution plans. The first resolution plan rule, jointly issued with the Federal Reserve Board, requires bank-holding companies with total consolidated assets of $50 billion or more and certain designated nonbank systemically important financial institutions to develop, maintain, and periodically submit resolution plans to regulators. The plans will detail the manner in which each covered company would be resolved under the Bankruptcy Code and will include information on credit exposures, cross guarantees, and organizational structure.

The second rule would require complementary resolution plans from insured depository institutions with assets of $50 billion or more.

In the event of a cross-border resolution of a covered financial company, the Dodd-Frank Act requires the FDIC to coordinate to the maximum extent possible with appropriate foreign regulatory authorities. Through the Financial Stability Board of the G20 countries and the Basel Committee, the FDIC and U.S. regulators are working to promote greater harmonization of national laws governing resolutions and improved coordination. We have also been engaging on a bilateral basis with foreign supervisors on resolution planning.

In regard to bank capital, interagency agreement has been reached on an alternative to the use of credit ratings as required by the Dodd-Frank Act that will be included as part of a Notice of Proposed Rulemaking to implement new capital requirements on assets held in a bank's trading book. This Notice of Proposed Rulemaking will be acted on by the FDIC Board at a Board meeting tomorrow, and this rulemaking is pursuant to a Basel Committee capital agreement.

Finally, given the effects of the recent financial crisis on community banks and concerns raised about the potential impact of the

Dodd-Frank Act on these institutions, the FDIC is undertaking a series of initiatives relating to community banks. The FDIC will hold a national conference early next year that will focus on the future of community banks. We will also organize a series of regional roundtable discussions with local community bankers around the country and undertake a major research initiative to study a variety of issues relating to community banks.

The FDIC will also undertake a review of our examination, rulemaking, and guidance processes to identify ways to make supervision more efficient, consistent, and transparent without compromising supervisory standards.

Mr. Chairman, that concludes my oral statement. I would be glad to respond to your questions. Thank you.

Chairman JOHNSON. Thank you.

Comptroller Walsh, please proceed.

STATEMENT OF JOHN WALSH, ACTING COMPTROLLER OF THE CURRENCY, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. WALSH. Chairman Johnson, Ranking Member Shelby, and Members of the Committee, I appreciate the opportunity to report on the OCC's progress in implementing the Dodd-Frank Act.

Since I last testified before the Committee on July 21, the integration of OTS staff has been successfully completed and the supervision of Federal savings associations has been integrated into our bank supervision operation. We also have continued our work to support the CFPB and the FSOC as well as our efforts to strengthen risk-based capital, leverage, and liquidity requirements. Finally, we have made significant progress on key regulations to implement the Dodd-Frank Act. So this morning, I would like to highlight a few of the items that are detailed in my written statement.

In operational terms, the integration of the OTS into the OCC has been successfully completed, but we are continuing to participate in a variety of outreach activities to maintain an active dialogue with Federal savings associations, including expansion of the former OTS advisory committees on mutual savings associations and minority institutions. Our integration efforts are now focused on coordinating and consolidating the various rules and policies that apply to Federal savings associations and national banks, and as part of this effort, we aim to eliminate duplication and reduce unnecessary regulatory burden.

Our dealings with the CFPB over the last several months have focused on consumer complaints and policy and exam coordination. The OCC has continued to provide significant OCC staff and infrastructure support to process consumer complaints on the CFPB's behalf.

With respect to rulemaking, the CFPB is required to consult with the prudential regulators prior to proposing a rule and during the rulemaking process. The CFPB currently has in process several rulemakings where interagency consultation will be critical, and we are working on a consultation agreement that will provide the prudential regulators reasonable time to review, discuss, and comment on CFPB rulemakings.

Another area of focus is the coordination of supervisory activities among the CFPB and prudential regulators. The Dodd-Frank Act requires the CFPB to consult with the prudential regulators regarding respective schedules for examination, to conduct their respect exams simultaneously, and to share and comment on resulting draft reports of examination. Some of these requirements do not mesh well with how bank examination activities are actually conducted, so the OCC and other prudential regulators are working with CFPB to develop an MOU to implement a practical approach to coordination that avoids unnecessary regulatory burden on insured depository institutions, which we believe to have been the Congressional intent.

The OCC continues to be an active participant in the activities of the FSOC. Since July, the Council issued its 2011 Annual Report to Congress and has held additional meetings and conference calls to discuss current market and regulatory developments that could have potential systemic risk implications for the U.S. financial sector and broader economy. Facilitating candid, confidential exchanges of information regarding risk to the financial system is one of the principal benefits of the FSOC.

A clear lesson of the financial crisis was the need to bolster the quality and quantity of capital held by financial institutions, as others have mentioned. Harmonizing Dodd-Frank capital requirements with the revised Basel standards is one of the principal challenges the OCC and the other Federal banking agencies face, and we are working with the other agencies to ensure the reforms are carried out in a coordinated, mutually reinforcing manner.

Finally, since the July hearing, the OCC has issued a number of proposed rules required under the Dodd-Frank Act on credit risk retention, margin and capital requirements for covered swap entities, and incentive compensation. OCC and agency staff are carefully evaluating the thousands of comments received on these three proposed rulemakings and are now actively engaged in considering the many issues raised.

More recently, and after months of intensive study and analysis, the banking agencies and the SEC jointly published the Volcker Rule, which is open for public comment through January 13, 2012.

In summary, since July, much has been accomplished. We will continue to move forward to complete the many projects underway. I look forward to keeping the Committee advised of our progress and I am happy to answer your questions.

Chairman JOHNSON. Thank you. I would like to thank all of our witnesses for their testimony.

As we begin questions, I will ask the Clerk to put 5 minutes on the clock for each Member.

Secretary Wolin and Governor Tarullo, how would delaying the implementation of Wall Street Reform leave the U.S. economy more susceptible to fallout from the European debt crisis? And Chairman Gruenberg, as the situation in Europe leads to the failure of large interconnected financial firms, is the FDIC prepared to resolve it? Secretary Wolin.

Mr. WOLIN. Mr. Chairman, the core elements of Dodd-Frank were designed to build a stronger, more resilient financial system, one that is less prone to crisis, less vulnerable to stress. And Eu-

rope certainly underscores the importance of moving forward with implementation of the statute to make sure that appropriate capital cushions and other enhanced prudential standards are put in place to make sure that derivatives are brought within the regulatory fold, to make sure that we continue to make progress on orderly liquidation authority and its modalities and living wills and so forth, so that we both can be best protected from whatever Europe provides us, but also whatever other stresses our financial system happens to encounter. So I think it is critically important that we move forward.

Chairman JOHNSON. Governor Tarullo.

Mr. TARULLO. Thank you, Mr. Chairman. Dodd-Frank was structured, I think, to respond to two kinds of stresses or problems in U.S. firms: One, some of the specific, if I can put it this way, internally generated problems that characterized the pre-crisis period with mortgage-backed securities and the like; and second, as Secretary Wolin just indicated, a generalized capacity to absorb loss.

I think what we are facing in Europe right now is the prospect of or the possibility of an externally generated set of problems for the U.S. firms rather than the internally generated problems. Here, I think that the capital is the most important consideration, and here, we began moving back in 2009 to push our institutions to enhance their capital buffers. Since the beginning of 2009, our 19 largest institutions have accreted or raised approximately $300 billion in capital, more than a 40 percent increase in what was held beforehand.

I do not think any of us would discount the possibility for difficulties in the United States if there were severe problems in Europe, but I do think that at the core, which is to say the capital and liquidity positions of our large institutions, we have made a lot of progress since the beginning of 2009, progress which is, I think, enhanced and rounded out by the Dodd-Frank provisions.

Chairman JOHNSON. Chairman Gruenberg.

Mr. GRUENBERG. Mr. Chairman, if we were confronted with the failure of a systemically important financial institution, it would only be in the event that the systemic resolution authorities of the Dodd-Frank Act had been triggered. If that were to occur, we believe we today have the authorities and the capability to carry out the FDIC's responsibilities under the law.

We have been working for the past year since the enactment of the legislation on internal resolution plans for our most systemically important financial institutions. We have been consulting closely with our fellow agencies and we have also been engaging with the foreign supervisors of the foreign operations of our major companies. So, if necessary, we think we are prepared today to carry out our responsibilities under the law.

Chairman JOHNSON. My office has been contacted by people from all across South Dakota deeply concerned about frozen accounts and missing funds connected with the collapse of MF Global. Chairman Gensler, Chairman Schapiro, what is being done to track down the estimated $1.2 billion in missing funds and what steps are being taken at your agencies and at the SROs you oversee to ensure the integrity of segregated accounts at other broker-dealers

and at FCMs to make sure that nothing like this ever happens again? Chairman Gensler.

Mr. GENSLER. Senator, as I am not participating in the matters of this specific company, it may be appropriate for someone else at the agency, or Commissioner Sommers, who is here, to follow up and take the specifics on the company.

But more generally, with regard to the importance of protecting customer funds and segregated funds, we are taking a number of steps. Yesterday, we finalized a rule on investment of customer funds. I have consistently felt we needed to do that since we proposed that in October of 2010. We are also working along with self-regulatory organizations, doing a limited review of the largest, even the smallest Futures Commission Merchants to ensure where they are as of November and December of this year.

But I did not know on the specifics whether you wanted——

Chairman JOHNSON. Commissioner Sommers, do you have anything you would like to add about the ongoing CFTC investigation?

Ms. SOMMERS. Thank you, Senator. The CFTC currently has dozens of staff members working on MF Global issues. We have auditors, investigators, and attorneys looking into the matter. We are working closely with the trustees, staff, and with the forensic accountants to make sure that we are tracing all of the transactions that went in and out of the customer segregated funds at MF Global. The number of different accounts and the number of different transactions that did occur has made this a very complex process for both our staff and the forensic accountants that the trustee is using, but we all are working through these issues and hope to resolve them very shortly.

Chairman JOHNSON. Chairman Schapiro, do you have anything to add?

Ms. SCHAPIRO. What I would add, Mr. Chairman, is that the securities side of MF Global was very much smaller, only about 400 active securities accounts, compared with many thousands of futures accounts. And while the company did not report a shortfall in the reserve account, the equivalent of the segregated account on the securities side, we are, of course, not relying on any representations whatsoever from the company. We are working closely with a SIPC trustee to ensure that money can be traced and recovered for the estate.

And we are also looking at our rules to see if there are other things we could be doing differently to bolster the integrity of the custody practices of broker-dealers. We have a very strong customer protection rule that already only allows customer funds to be invested in U.S. Government securities that are backed by the full faith and credit of the United States. But we have also proposed some rules with respect to requiring separate audits of broker-dealer custody practices that would also enhance SRO and SEC examination authority of broker-dealers and would require broker-dealers to file regular reports with the agency with respect to their custody practices. And there is a pending FINRA rule proposal out for comment right now that would greatly enhance financial reporting by broker-dealers. So we are also looking carefully to see if there are additional things that we can be doing.

The trustee has filed a motion with the court to transfer the bulk of those 400 securities accounts to another firm and that motion will be heard on Friday by the court.

Chairman JOHNSON. Chairman Gensler, CFTC staff participated in the interagency effort in questioning the Volcker Rule proposal, but the CFTC did not sign on to the joint text adopted by the other regulators almost 2 months ago. When can we expect the CFTC to issue its Volcker Rule proposal, and will there be any differences in the CFTC proposal from the text issued by the other regulators in October?

Mr. GENSLER. Mr. Chairman, we did at a staff level participate and I would envision that we would move forward with the proposal consistent with what other regulators have done. It has really just been a capacity issue of bringing things forward to a Commission. We had our last meeting in October 18 and then the next on December 5. We also had a changeover of one Commissioner retiring and another one coming on board. So I would envision to get feedback from staff and Commissioners and move forward with something consistent with what other regulators have done.

Chairman JOHNSON. My time is up, but I do have additional questions for all of you regarding QRM, Wall Street Reform implementation road map, the FSOC, and oversight of the SEC.

Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

Chairman Gensler, according to the MF Global bankruptcy trustee, as much as $1.2 billion or more of customer funds are missing from the CFTC—are missing there. The CFTC is the regulator. Where have you been there? And second, do you know where the money is?

Mr. GENSLER. Senator, as I am not participating in the matters, it may be appropriate—I do not know if——

Senator SHELBY. Why are you not participating, for the record?

Mr. GENSLER. No, absolutely, sir. I think it is a good question. Though the attorneys at the CFTC, the Chief Ethics Officer, and the General Counsel had indicated to me that they did not see a reason, legal or ethical reason for me to not participate, I reached out to them that as it turned to an enforcement matter and before we had our first closed door surveillance meetings—we have closed door surveillance meetings every Friday and have for 30-plus years—and said I did not really want my participation to be a distraction—there had already been some questions—from this important matter.

Senator SHELBY. Are you not participating because of a prior relationship with the Chairman of MF Global, Jon Corzine?

Mr. GENSLER. I had left Wall Street 14 years earlier, but I had participated with this Committee, actually, with Paul Sarbanes——

Senator SHELBY. I understand.

Mr. GENSLER.——on the Dodd—oh, no, that was called Sarbanes-Oxley.

Senator SHELBY. But did you recuse yourself because of your relationship, past or present, with the Chairman of MF Global, Mr. Corzine?

Mr. GENSLER. I—I indicated to our General Counsel that Thursday, November 3, that I thought—that I did not want my participation to be a distraction——

Senator SHELBY. So the answer is——

Mr. GENSLER.——from the very important matters——

Senator SHELBY.——yes or no?

Mr. GENSLER.——going forward——

Senator SHELBY. Wait a minute. Wait a minute. I asked you a question. Did you recuse yourself from proceedings dealing with MF Global because of your prior relationship with Mr. Corzine way back 14 years ago or currently, or a combination?

Mr. GENSLER. Well, it was—it might even have been broader. I just did not want to be a distraction because I had been at the same firm and he had been my boss, but also——

Senator SHELBY. Well, you thought you might have a conflict or the perception of one, is that right?

Mr. GENSLER. No. What the lawyers told me pretty straightforward was there was no reason that I needed to not participate. But as it turned to an enforcement matter and an investigation about these very important matters, because it is critical to find out where the money was, I did not want my participation to be a distraction from the very—there are excellent career staff at the CFTC——

Senator SHELBY. Let me ask you another question here.

Mr. GENSLER. Sure.

Senator SHELBY. Since you have been Chairman of the CFTC, has the Chairman of MF Global contacted you or the CFTC regarding the regulation of MF Global in any way?

Mr. GENSLER. I do not know about his contacts with the rest of the agency. There was one courtesy meeting——

Senator SHELBY. Wait a minute——

Mr. GENSLER.——at the very beginning of——

Senator SHELBY. So you had a meeting. There was a meeting there. You called it a courtesy meeting. But you had a meeting with the Chairman of MF Global, Mr. Corzine, right?

Mr. GENSLER. There was a courtesy meeting when he took the job, and then there was one staff phone call——

Senator SHELBY. Now, was the meeting—excuse me. I do not mean to be rude——

Mr. GENSLER. No, I am sorry——

Senator SHELBY.——but I want to get the point.

Mr. GENSLER. Right.

Senator SHELBY. Was the meeting at CFTC?

Mr. GENSLER. Yes. Yes.

Senator SHELBY. And was it after Mr. Corzine became Chairman of MF Global?

Mr. GENSLER. Yes, it was, sir.

Senator SHELBY. And what did that have to do with him taking the job, meeting with you, or meeting with your staff or members?

Mr. GENSLER. He was head of an agency—head of a company, and he came by and there were staff at the CFTC——

Senator SHELBY. OK.

Mr. GENSLER.——and myself there, yes, in the spring of 2010.

Senator SHELBY. Did you or any of the staff ever have any conversations, dialogue, or interaction with Mr. Corzine regarding the regulation of what he could do and not do at MF Global?

Mr. GENSLER. Well, as reported on our Web site, there was one general call——

Senator SHELBY. Well, I am not interested in reporting on the Web site. Just tell us what happened.

Mr. GENSLER. Well, it was a broader thing. In July of this year, there was reaching out—as part of the 1,100 meetings that we have had on the Dodd-Frank rulemaking, one of them included CFTC staff, myself. It was a telephone call about this rule about investment of customer funds.

Senator SHELBY. So you had a meeting there regarding the Chairman of MF Global, right?

Mr. GENSLER. That is correct, conducted by telephone. That is correct.

Senator SHELBY. Now, my last follow-up is part of my first question to you, because my time is limited. Do you or the CFTC, do you know where the $1.2 billion is today——

Mr. GENSLER. I am not participating——

Senator SHELBY.——and if you do not know, why do you not know?

Ms. SOMMERS. Senator, we are working closely with the forensics accountants that have been hired by the trustee to try to locate any missing customer funds. We continue to work through those issues, but we have not located all the funds that are missing, but we continue to——

Senator SHELBY. So the answer is you do not know where the money is.

Ms. SOMMERS. That is right.

Senator SHELBY. Thank you.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Reed.

Senator REED. Well, thank you very much, Mr. Chairman.

Governor Tarullo, let me begin with you. You and your colleagues have a complicated challenge implementing the Volcker Rule, and that is to me a broader issue with respect to how derivatives and complicated instruments are going to be treated on the books of these major companies. It is complicated. That is why Congress directed the agencies do it because the process of reaching out, getting opinions from the affected industry, getting comments, *et cetera,* is something that in our legislative process we do not do as systematically.

But the other complicating factor here, too, is there has, I think, clearly been an attack on the budgets of the agencies so that their resources are in question whether they can carry out some of these sophisticated issues. And we are also seeing at least the potential for challenges at the circuit court on the Administrative Procedures Act with respect to the economic analysis, and I find that interesting because that was not even part of Dodd-Frank. That is a predecessor statute that called for consideration of the economic consequences, not a cost/benefit analysis. I think the courts are writing a lot into that statute.

But all of that having been said, in this period of time where it is very difficult to deploy effective rules with respect to Volcker, with respect to clearing platforms, with respect to the treatment of derivatives, the only fallback I think you have is capital—capital that will assure the Congress and the American public that they will not have to go in and once again, as they did in 2008, provide huge direct financial support, and as we have discovered recently, indirect financial support through the borrowing facilities of the Fed.

Is that your perspective? Are you prepared to explicitly consider the additional capital that these institutions must bear if we cannot effectively deploy these rules?

Mr. TARULLO. Senator, as I indicated earlier, we have been proceeding with the improvement of capital regulation across the board. With respect to the trading side of major institutions where obviously the Volcker Rule has particular salience, we are on the verge of putting out a proposed regulation along with our fellow banking agencies which would implement the so-called Basel 2.5 rules. Those are the ones applicable to the trading books.

Second, when we did the capital review exercise earlier this year and as we undertake it again, which we have just begun to do, for early 2012, we have including for our largest institutions a so-called trading book shock, something which would essentially build on the 2008 shock to traded assets to stress test them under the current environment. This year we have also added a specifically European component to that, taking into account the potential impact on sovereigns in the European Union.

The reason I mention the stress test part of this is back to the point I made in my introductory remarks, that we need a dynamic as well as a static picture of capital, and so what we tried to do in these stress tests is to say assume an adverse scenario, assume bad things happening, both in the banking book and the trading book, and make sure that the firms could sustain the kinds of losses associated with that adverse scenario and still emerge sufficiently well capitalized to be a viable financial intermediary.

So I absolutely think that capital is central here. I realize I have become a bit of a broken record on this, but I do think that capital is the foundation for a well-structured financial regulatory system which definitely needs to be complemented with other forms of regulation.

Senator REED. But without these other forms of regulation, then—and I do not want to put words in your mouth—it would seem to me that the capital level would be some percentage point higher because you do not have these other complementary transparent platforms or rules and——

Mr. TARULLO. When we set capital requirements, we do try to look at how those requirements relate to other regulatory arrangements. So I think it is the case that in the absence of, for example, restrictions on proprietary trading, we would need to look at the potential losses associated with an unregulated proprietary trading undertaking.

Senator REED. So there is a point, at least analytically, at which if the Volcker Rule was adopted and these other measures—more effective use of clearing platforms, more products being traded,

cleared, rather than over-the-counter bilateral transactions—that potentially at least capital would not be as high for banks. And I find one of the ironies is that, you know, the industry and others are fighting so hard against these, and they may end up with higher capital levels that impede their ability to lend, to participate in the economy. And I guess the moral of the story is, at least I hope it is, you cannot have it both ways. You cannot undermine all of these regulatory structures and then expect to have very low capital levels because there is no protection for the taxpayer.

Mr. TARULLO. Certainly, the riskiness of a particular asset is affected by the regulatory environment in which that asset can be purchased, and I think that is a core point. Obviously, if a firm is able to take on a substantial portfolio of risky assets, capital requirements will have to be higher.

Senator REED. Thank you very much, Mr. Chairman.

Chairman JOHNSON. Senator Johanns.

Senator JOHANNS. Thank you, Mr. Chairman.

Chairman Gensler, this is the second time that you have appeared, before me at least, since MF Global hit the front pages, and I must admit your nonparticipation explanation makes less sense to me today than before you appeared the first time. Let me try to understand this.

You worked for former Senator Corzine 14 years ago. Is that correct?

Mr. GENSLER. Well, I worked with Goldman Sachs, the firm, for 18 years, finishing in 1997. That is correct.

Senator JOHANNS. Right. And up until the time you decided on November 3rd that you were not going to participate anymore, you had regulated MF Global. Correct?

Mr. GENSLER. Yes, as Chairman of the Commission overseeing 125 futures commission merchants and thousands of other registrants.

Senator JOHANNS. Never occurred to you prior to November 3rd that you should not be participating with MF Global?

Mr. GENSLER. I raised the question with the staff when I came on board at the CFTC which companies to be involved in or not involved in, and they had said there was no specific reasons not to participate. But then as this turned to an enforcement matter—October 31st, Halloween—as it turned to an enforcement matter, they repeated that, but as we were getting closer to that Friday surveillance meeting, I had indicated to them that I thought that it would be best not to be a distraction, the hard-working and very excellent staff of the agency with regard to something that could be a specific investigation about specific individuals as well, and——

Senator JOHANNS. Why would you be a distraction? You see, what it feels like up here, having been in something like your seat myself, is that when this got uncomfortable because money is not there that should be there, and for whatever reason you folks did not discover that until it looks like it is too late, you do not want to come up here and answer questions. Every hard question you are asked, you said, "Well, I am not participating," and you asked Commissioner Sommers to step up and offer something. And to me it looks like you are ducking the responsibilities of your job.

I do not understand why you would be a distraction.

Mr. GENSLER. Senator, I take the responsibilities of the job very seriously, and I think that the protection of customer funds and positions is just paramount and it is core to our regime and the farmers and ranchers and many energy merchants because those are the people that really need to work on and use these instruments to hedge are critical to this. So——

Senator JOHANNS. So when——

Mr. GENSLER. I would far prefer, actually, as you suggest, to be able to address it. But when I turned to the general counsel—and this was—in my 2 ½ years, this is not the first time that I might not be involved in a specific investigation of individuals where there is excellent career staff, 170-plus attorneys and so forth in the enforcement areas—there are auditors and so forth—to get the direction of four other excellent Commissioners and not be a distraction by my personal involvement and participation, and it——

Senator JOHANNS. But as——

Mr. GENSLER.——turning to an enforcement matter.

Senator JOHANNS. But as President Truman so famously observed, the buck stops with you. So after this hearing, when farmers from Nebraska call me and say, "What did Chairman Gensler say about getting my money back?" My response to them is, "Well, he did not want to become a spectacle, and so he is not participating, and I have nothing to offer in terms of where Chairman Gensler might be on that. He has got good staff, and they are handling it."

But, you see, from our standpoint we want a person to come before us and answer the hard questions. That is what your job is about, and it just feels to me like you are not discharging the responsibilities of that job.

Mr. GENSLER. Well, I feel, sir, that I am. I am doing it to the best of my abilities, and I had a judgment, and it was not the first time over these 2 ½ years when it turns to an enforcement matter that may involve particular individuals—and in this case, though it was 14 years earlier, and 9 years earlier when the Sarbanes-Oxley work was done—that that Thursday I said to the general counsel, you know, "What do you recommend here? And how do you have me not participate so I am not a distraction to the American public and to the important matters?" The critical matters that we do share on this is ensuring that customer funds are protected, that money is accounted for, that segregation happens every day, and that people can have confidence in these markets.

Senator JOHANNS. Well, let me just wrap up with this. It seems to me very, very fundamental. If you have money from customers in this account and you have your own account over here or the company's account, you do not mix the two, and you do not appropriate money from customers to do your own risky trading. That seems to be basic. I bet that has been the law since the beginning of time, and this is not tough. And I do not understand, and you are not clarifying for me why you would not be participating in this.

Mr. GENSLER. In terms of the law, the law is absolutely clear. The Commodities and Exchange Act is clear. There were some exemptions granted in 2005 that yesterday the Commission voted to narrow and take back, but there were exemptions granted in 2005

about lending customer money to other parts of a firm through something called "repurchase agreements." And in October of 2010, we proposed to narrow that, to dial that back. I have been consistent about that for these 14 months and believed that we needed to do that. But we went through, you know, the healthy process of notice and comment and hearing from the public as well.

Senator JOHANNS. And that is not what happened here.

Mr. GENSLER. Well, I cannot comment on the specifics of that.

Senator JOHANNS. Yes, because you are not participating.

Chairman JOHNSON. Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman.

Secretary Wolin, let me ask you, 60 Members of the Senate voted to pass the Wall Street Reform Act. That is well beyond a simple majority. That included the Consumer Financial Protection Bureau.

Now, it seems to some of us that it is both unprecedented and rather extreme for Republicans to refuse to confirm anyone, regardless of how qualified they are, as Mr. Cordray is, to lead an agency because they oppose the existence of an agency that is accountable in a dozen different ways under the law, and that is meant to help consumers versus large financial institutions. If Republicans in the Congress continue to oppose even an up-or-down vote—you know, they do not have to vote for this person, but allowing us to have an up-or-down vote to confirm a Director—can you explain what the practical consequences of not having a Director means for consumers, for middle-class families, for this agency?

Mr. WOLIN. Thank you, Senator, for that question. Absolutely, as you have said and as my opening statement says, without a confirmed Director in this position, the Consumer Financial Protection Bureau will not have authority to supervise and enforce very common-sense consumer protections with respect to payday lenders, mortgage brokers, mortgage lenders, mortgage servicers, and student loan providers. And I think if you look at what the Consumer Bureau has done to date, you see the kind of overwhelming importance of their effort. They are trying to make clearer mortgage disclosure, clearer credit card disclosure, clearer disclosure for students who take out loans. They are trying to help servicemembers and seniors make sure that they get the information they need in a clear form so that they can make essential choices about what consumer products they want to purchase or not and what kinds of variations of those products. And we know that the absence of all that disclosure was an important element of what caused the financial crisis in 2008 and 2009.

And so from our perspective, we are talking about very commonsense, very tangible protections for everyday Americans of all sorts with respect to some of the most important financial judgments they will have to make.

Senator MENENDEZ. And isn't it true that, for example, community banks and credit unions will be at a disadvantage because they will have to live under the regulations but nonbank institutions or certain others—there is a whole universe of institutions that cannot be regulated, unlike community banks and credit unions, unless there is a Director to help promulgate the regulations?

Mr. WOLIN. That is true, Senator. The Consumer Bureau has authority now to do these things with respect to banks. It is only the nonbanks that they do not have that authority. So we have the unhappy circumstance of banks being regulated in these ways, which they should be, but all the nonbanks, with whom millions and millions of Americans engage every day, are not being looked after in this way.

Senator MENENDEZ. And in pursuing this line of questioning in a different respect, I have heard a lot of rhetoric about regulations of Wall Street causing a loss of jobs or slowing economic growth. But can you name a single action in all of American history that caused a greater loss of American jobs or slowing the growth that we have had in this economy than when we allowed Wall Street financial institutions to largely do whatever they wanted running up to the financial crisis that culminated in 2008? Isn't it a fact that it was the failure to regulate big Wall Street banks and the derivatives market that caused the losses of millions of American jobs over the last several years?

Mr. WOLIN. Well, we know, Senator, that the financial crisis led to the destruction of enormous amounts of job and wealth and people to lose their homes. We know that an important reason for that was our not having a financial regulatory system that was adequate to the task. That is why the enactment by this Congress of Dodd-Frank was so critical and that the implementation work that my colleagues to the left are currently engaged in is so critically important so that we make sure that we have a system that is stronger and more resilient and that better protects not just the financial system but the well-being and the resources of Americans across our country.

Senator MENENDEZ. And, finally, on a different matter, as the Subcommittee Chair on Housing, I am very concerned that if the qualified residential mortgage definition being worked out—there are several of you, I understand, who are engaged in this, so I would like you to respond to that—by regulators is not broad enough, it could hurt the housing market, especially if you proceed with high downpayments of 20 percent or more, which is where the marketplace has already taken itself to in expectation that this is what you are going to do. Now, that is a whole universe of very responsible borrowers that will be largely eliminated at the end of the day.

For example, that was a universe in which I bought my first home, and I have been a very responsible borrower over a long period of time. Why would you seek to eliminate that whole universe of very potentially responsible borrowers by, you know, systematically just saying 20 percent or above is the mark?

Mr. WALSH. I am happy to start on that one. The QRM is a narrow definition in a risk retention rule, and the basic point of the rule, we believe, and the requirement in law is to encourage risk retention in securitizations. The question is: Should there be exemptions or exceptions to the securitization requirement? And the QRM definition is drawn pretty narrowly in order to identify mortgages that are so well underwritten that no risk retention is needed, but then leaving substantial space for other products that do

not meet the QRM definition to be provided to the market, but to do so within the risk retention framework that the law requires.

It is one of the issues we have to confront. There have been many, many, many comments on that issue. But it is not intended to define what an acceptable mortgage is. It is intended to define an exception from the broader rule. So it is one of the things we will be grappling with.

Senator MENENDEZ. Are you going to be—you know, there is a lot of uncertainty surrounding whether your next step is to issue final regulations or another proposed version. Can you assuage the concerns of borrowers and lenders alike by saying you plan to issue a reproposal?

Mr. WALSH. Well, that is a collective decision of people down the table here based on the comments. I think for myself it will depend on how different a proposal we are looking at once we have made the series of decisions in response to comments. If it is very fundamentally different, then I would like to see more comment. But we will have to decide that collectively.

Senator MENENDEZ. Mr. Chairman, thank you. I just want to say there are many different ways in which we look at how to make sure that risk is reviewed. I just find this movement toward this 20 percent to me to be arbitrary. It is one of a series of factors that should be considered, but it should not be the driving factor. And this housing market does not need any more body blows to it if we are going to lead to a recovery.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Moran.

Senator MORAN. Mr. Chairman, thank you very much.

Chairman Gensler, based upon your voluntary recusal, I do not think you can answer this question at this moment, and it is not necessary for your colleague to join us at the table, but maybe the CFTC could answer this.

I thought the CFTC, at least at first blush, made sensible reform yesterday in regard to the use of the segregated accounts, altered the investment opportunities for customers in those segregated accounts. And while that does appear to me to be sensible, everything that I have read about MF Global, I do not see that that rule would have changed any of the outcome of what has transpired at MF Global. And while they may have been doing things with that money that this rule would affect, we really have—I mean, what I read is we have fraud. We have the taking of customers' funds and they are gone.

So I would like to have the CFTC explain to me why this change in this rule may have been a tool that would have prevented what occurred at MF Global from occurring, and no need, again, for you to answer that today, but if the CFTC could respond to the Committee with that question, I would appreciate it.

Senator MORAN. Then let me ask Chairman Schapiro a question. Senator Warner and I soon this week are going to introduce legislation that we hope will generate additional startups and revive entrepreneurship in this country's economy. President Obama has talked about Section 404 of Sarbanes-Oxley. We heard testimony last week in this Committee about how it remains one of the most egregious deterrents toward entrepreneurs, small business men

and women accessing capital, but I do not know that you or the—SEC has said anything about the cost/benefit analysis of Section 404 and its compliance as it relates to small firms.

Ms. SCHAPIRO. Senator, I am happy to talk about that. As you know, we share the concern about access to capital for small businesses. We have created a new advisory committee that is helping us confront small business capital formation issues. We are looking at all kinds of initiatives, including raising the limit on Regulation A offerings, whether 500 shareholders is still the right number for a company to have to begin publicly reporting to the SEC, whether we should relax the general solicitation ban, and a number of other things, crowdfunding and others. So we have a lot on our plate and a lot of initiatives ongoing.

I will say that I have personally weighed in with a concern about raising the 404(b) exemption as high as, I believe, some bills are considering doing. It is currently $75 million, which, in fact, covers 60 percent of all public companies. Those companies do not have to do 404(b) reporting. To go to $1 billion, which I think some bills are contemplating, would concern me because we have understood from investors consistently that the independent auditors' reporting on internal controls is, from their view, a very important investor protection and gives them a lot of confidence when investing in companies. And the worst result I think we could have would be for investors to lose confidence generally again, as they did after Enron, in the quality and the integrity of financial statements. And the bigger the company gets, the more the concern I would have about that.

In addition, it is not at all clear to us—and we look at these considerations very carefully—that exempting from 404(b) for these larger companies would, in fact, save audit costs, because internal controls have to be tested in the audit of the financial statements, anyway.

So we would be happy to work with you and talk with you in detail about it, but I do have some concerns because 404(b), investors consistently tell us, has been very important to their willingness to commit capital.

Senator MORAN. Well, I do think it is important that we have your expertise, the SEC's expertise on this topic. I think it is timely. I think entrepreneurship, startup companies are a great opportunity for our country's economy, and I do know—I mean, I sincerely believe there is an impediment, but we need to find the right threshold, the right balance for protection, but also to increase the opportunity to access capital. And so I would welcome your more timely answers to those questions.

My final question, and it is a broad one, and this comes from Chairman Johnson's question. My take on what I heard across the table was that Dodd-Frank—and I was not on this Committee at the time that Dodd-Frank was passed and signed into law. It may have reduced the risk of failure of financial institutions that create a systemic risk, and regulators have additional authorities to wind down businesses that are failing. But I did not hear anybody indicate that Dodd-Frank reduces the number of institutions that are too big to fail, that would meet that definition, that the public, I think, and me as a Member of the House of Representatives

thought Dodd-Frank was addressing, reducing the number of firms that, if they failed, there would be a systemic risk. And what I heard today in your response to the Chairman's question was nothing suggests that the concentration of economic power is any less today or that there are fewer firms whose failure would cause a dramatic consequence to the U.S. economy, but two things—nothing wrong with either one of those two things, is we have greater authorities to wind down one of those firms in that circumstance, and we have a greater opportunity to prevent any of those institutions from risky behavior that causes them to fail.

What have I missed in that discussion that you had in response to the Chairman's question?

Mr. WOLIN. Senator, I think all those things are true; that is to say, the statute decreases the probability that firms will fail by making sure that they are better protected, better buffered, have stronger standards, are engaging in less risky activity; and also, of course, as Chairman Gruenberg noted, we have new tools, the Government does, to deal with failure if and when it does occur in ways that are orderly and that do not require the taxpayers' resources to deal with the situation.

But I think it also does this, which you are getting at: It makes sure that firms are better protected from each other so that the buffers, the kinds of things that make it less likely for any one firm to fail help make sure that when a particular firm fails, other firms are better insulated, better protected from those circumstances. One key element of that whole dynamic is what Governor Tarullo has pointed to as being, of course, a central aspect of this, which is capital. And there are lots of other ways, and I am sure other colleagues on the panel can speak to them. But I think it is all of those things. It is reducing the likelihood of failure, better making sure that other firms are protected from failure of a particular firm, and dealing with a firm that fails in a way that is orderly and is protected from the taxpayer.

Mr. TARULLO. Senator, let me just add two things to what Secretary Wolin said.

First, I do think it is important that market discipline play a much greater role than it did in the pre-crisis period. So a number of the things that we are talking about here, whether it is the FDIC's orderly liquidation authority or the enhanced prudential standards, the disclosure that we are doing in accordance with the stress tests, all of those are means to enhance market discipline as a complement to basic regulation.

The second thing I would say is that there are two forms of systemic risk that we need to be concerned with. One is the one you highlighted, which is the number of firms which in and of themselves would cause a systemic problem if they were to fail. But second is a set of activities, correlated activities within the financial system that may be conducted by a broader number of not huge organizations, which themselves could create some systemic risk if, for example, there were a shock to the value of the assets that were underlying those transactions. And that is really what MBS was. MBS involved big institutions, to be sure, but it involved a lot of others.

So when you talk about derivatives reform, central clearing and the like, you are talking as much about systemic problems that can arise in nongigantic firms as well as gigantic ones. But I will say to you quite honestly, I think we are going to need some more work and thinking there to make sure that we are identifying those forms of risk and not just allowing an arbitrage out of one set of institutions into another.

Senator MORAN. When you say market discipline, is that my phrase "moral hazard"? Is that what you are——

Mr. TARULLO. It is the other side, it is the flip side of moral hazard, sir, yes.

Senator MORAN. OK. Thank you.

Chairman JOHNSON. Senator Merkley.

Senator MERKLEY. Thank you very much, Mr. Chair.

I want to start with a brief discussion on the difference between qualified residential mortgage, which was an exception to the risk retention rule, as Mr. Walsh pointed out, and qualified mortgage, which was a term used to define a mortgage that meets ability-to-pay standards—in other words, getting rid of the liar loans.

Mr. Wolin, under the section for the qualified mortgage, again, the ability-to-pay standards, a series of requirements are laid out, and those requirements include not being a balloon mortgage, being fully amortized, not being negatively amortizing, being verified income, and so forth, and meeting the ratios in regulation or statute for debt to income, all of those basically, yes, it has been underwritten and ability to pay.

Two terms are used in this section, one of which refers to a presumption and the other to safe harbor. Now, technically those are two different things in the law, and I think you have produced two different rules based on which direction the rules will go, two different draft rules.

Do you have a sense right now which way you are going to go on this?

Mr. WOLIN. I do not, Senator. I think it has yet to be determined, and I think how the QRM and the QM, which, as you note, have different purposes but also have some interplay, relate to one another is, I think, also something that needs to be worked through in the end, of course, by regulators. We will, you know, offer our views, and in the case of the QRM rules, we have a coordinating function that the statute provides to us, but the regulators will, of course, in the end make their judgments.

Senator MERKLEY. The qualified mortgage is completely under this section presumption of ability to repay and is distinct and different from the risk retention version.

Mr. WOLIN. Right.

Senator MERKLEY. I will note that later in that section there is a reference directly to the safe harbor. Certainly that was the discussion that was taking place among those of us who were immersed in trying to get rid of the liar loans, was that you would have a safe harbor. Thank you.

Governor Tarullo, I wanted to turn to the G–SIFI surcharge, and I believe that earlier in the year you called for a surcharge, which we might call an anti-bailout equity buffer, of as much as 7 percent which could bring the total amount up to 15 percent for tier one

capital ratio. But I think the Fed ultimately adopted 3 percent, that is, essentially instead of getting to 15 percent, they get to 11 percent. And for most organizations, under the scaled bucket structure, it would only be 1 percent or 2 percent.

So is it fair to say that you lost and that you are still concerned about that?

Mr. TARULLO. No, so, Senator, what I said in that speech, in June, I believe, was that the methodology that we—which is to say Fed economists—had pursued in trying to calibrate what an appropriate surcharge would be had produced a range of possible surcharges that would have been somewhere between 1.5 and 7 percent. As you indicate, the Basel agreement was for 3 percent as being at the top. That is obviously within. And the 2 to 2.5 that would apply to a lot of SIFIs is obviously within that range.

I did not at the time propose it, but I did want people to see that a methodology which asked the question how can we equalize the risk of failure of one of these systemic institutions and the impact that it would have on the financial system to that of a medium-size institution could under some not implausible assumptions produce an amount of a surcharge greater than we had intended to propose.

There are other—this is relevant to my response to Senator Reed's question earlier. When one thinks about which number to choose once you have gotten a range, I think you want to take several things into consideration: one, how are you feeling about the underlying capital system, the quality of capital and the like; two, to what degree are there other regulatory structures which suggest that you need to go higher or lower in that range that you have got; and, three—and I think we do take this into consideration—the degree to which we can get agreement from our international counterparts to move their SIFIs in a similar direction.

So, you know, as with Basel III, personally I would have been a little happier with a little higher number, but I do think that the numbers that we got in the international negotiations and in coordination with the OCC and the FDIC are well within that range which analytically we think will provide the kind of additional buffer support that is needed.

Senator MERKLEY. Thank you. Because my time is out, I will just close by noting that the total amount of buffer becomes much less than many such as those at the Stanford Business School have proposed, and this is in the context of certainly significant exposure to European banks and some exposure that is not fully understood in terms of the credit default swaps and how the dominoes line up in that manner. So I applaud your ongoing effort to have this first line of defense be one that is robust and substantial.

Thank you.

Chairman JOHNSON. Senator Corker.

Senator CORKER. Again, Mr. Chairman, thank you for calling the hearing, and I thank each of you for being here.

Mr. Wolin, the CFPB, the Consumer Financial Protection Bureau, we have had numbers of conversations about it, and I have talked to the White House several times over the course of the last several months. But, you know, in fairness, even the Treasury's proposal that came forth regarding the Bureau had a board, and

even the Treasury Secretary has said, yes, you know, we felt there should be a board.

I do not know whether you are enjoying being part of a political game that is taking place regarding this, but I would just say, look, some basic checks and balances with this organization I think would cause the logjam that is taking place on this to really be broken up, and I am sort of surprised that you all continue to be a part of this political game that is taking place. But I do hope at some point in time we will be able to have a meeting of minds and have just a simple kind of thing that most people in Tennessee and across our country would like to see, and that is some accountability. But I hope that will happen, and you do not need to answer that. I know it is not going to happen this week because everybody is having so much fun with it.

But on GSEs, in February you all came forth with sort of a multiple choice of what could happen with GSEs. I am surprised that you have not come forth with any solution toward the GSEs, and you do not have to go on forever, but explain to me why you have not. I mean, it is a pretty basic issue that all of us know needs to be dealt with. We had looked forward to working with you, and when we realized you really just did not have the appetite for taking it on, we have offered a bill ourselves. I hope you will look at that, but could you tell us why you are not really pursuing any type of GSE reform at this time?

Mr. WOLIN. Well, Senator, let me—and I want to come back to the CFPB thing, if I might for a second as well. We are keenly interested in pursuing proposals for housing finance reform. We laid out some options, as you note. We continue to work on refining sort of what we think the right approach is and have tried to be clear, working with folks across the Congress, that we are keen to engage in that conversation.

So we have been continuing to work on plans. We have engaged——

Senator CORKER. Are you going to come forth with a plan?

Mr. WOLIN. Well, I do not know whether we are going to have a specific thing or when, but certainly we hope to. This is obviously critical, and at some point we will be bringing something forward.

Senator CORKER. I would just say in general the observation is that you all are really succumbing to politics and are unwilling to take on the tough issues that need to be dealt with that really cause people in our country to be divided taking on tough issues like this and really promoting other political stances like you are right now, the CFPB, and not trying to solve it. So I just want to tell you it is disappointing, and I do hope that very soon somehow that might change.

To you, Mr. Gensler, I was not really——

Mr. WOLIN. Could I respond to that, Senator?

Senator CORKER. Sure, if you can do it briefly.

Mr. WOLIN. I think we have tried to take on lots of very complicated——

Senator CORKER. You have not taken on GSEs as you said you would. You have not done that. You have not taken it on. You came out with a multiple choice that makes everybody happy, and you did not do what you said you would do. You all said you all would

come forth at the beginning of this year with a real proposal. The year is almost over, and you have not done that.

Mr. WOLIN. I would say this, Senator, that we have put out some very serious ideas. We continue to work on proposals, and we will work with whoever on the Hill wants to continue to work with us.

Senator CORKER. Good. Thank you.

Mr. Gensler, I was not going to weigh in on this. I figured others would do it. I do have some other questions I want to ask other folks. But I just was not going to do it. I have to tell you that it appears to me—I do not know if you would make the same decision again, but the people that care about MF Global really care about what happened running up to the point in time that you recused yourself. I mean, the enforcement piece, it will take its own course, and I am sure it will be tough. But it feels to me like you panicked, and it was more about a career-enhancing situation to avoid accountability. And I just have to tell you as a person, I know I fall short of this, but I do try to take on the tough issues and not dodge tough issues. You know, I may not be coming back because of that. But, you know, it appears to me, candidly, that you really took a career-enhancing—I think it has actually not turned out to be the case, but a career-enhancing position by trying to take yourself out of this at a moment in time when really the rest of—I mean, Corzine is not the chairman anymore of the company, so it seems like now is a great time for you to be involved. But I was disappointed with your testimony, and I would love to talk to you about it some other time. But it does not seem to me that it makes any sense at all and was done solely to enhance your career here.

Mr. GENSLER. Senator, I would look forward to that, and I feel that you have given me good advice throughout my 2 ½ years here. But really what happened is, as it turned to a specific enforcement matter that could involve specific individuals, not just the company but specific individuals, about compliance with laws, not just one law but various laws, and there were some questions coming that Thursday I was up in the Senate testifying on position limits, actually, but I reached out to the general counsel, and I said I know that you are saying that it was 14 years ago and 9 years ago and so forth, but that my very participation could be such a distraction on the enforcement matter. And then I said, "So what do we do elsewise?" And to your very good question, the general counsel said, "Well, enforcement involves, the bankruptcy involves the very heart of the questions of where is the money," and so forth.

So I do not think, sir—and I appreciate what you are saying because it is a balancing. All of us that are in this town, there is a balancing of these very hard decisions. So I made a judgment on that Thursday. It was certainly not for the reasons you are saying because you have observed this is still a very challenging topic. Even not participating it is a challenging topic.

Senator CORKER. Well, thank you.

Mr. GENSLER. It was a balanced judgment.

Senator CORKER. And let us talk about that.

Mr. Wolin and Mr. Tarullo, I know Treasury, when Volcker came out, my guess is that there were people at Treasury that thought, "What in the world?" especially when it came out. And I know Treasury first opposed Volcker internally, and now it is part of our

law. And over time I guess you have figured out the best way to deal with Volcker was to make sure that treasurys were exempt from Volcker. All other trading in debt is going to become far less liquid—in other words, you buy a GE bond or somebody else, there is going to be no liquidity. But you artfully exempted treasurys so it would not have any effect on Treasury's ability to have liquidity in trading debt instruments that are very important to you.

I am just wondering if you think that was an appropriate response to Volcker, to basically say, OK, we will let it apply to everybody else but us? I wonder if you and Tarullo might respond to what that is going to do in debt markets by crowding people out of the private side and, candidly, causing people to more focus on something that they know is highly liquid?

Mr. WOLIN. Let me start, Senator, by saying we were in favor of the Volcker Rule. I came before this Committee and testified with Paul Volcker and was clear about——

Senator CORKER. Not in the beginning.

Mr. WOLIN. The statute was the creation of this Congress. I think from our perspective we wanted to make sure and I think industry was keen for us to make sure that we excluded certain things from the provisions. How that gets worked through in the rulemaking obviously is not for the Treasury to participate in, so I will defer to Governor Tarullo. But I have a hard time imagining that this is going to have a particularly important effect when all is said and done on the overall debt markets and their liquidity.

Mr. TARULLO. Senator, with respect to liquidity for other instruments more generally, I think a lot of this will depend on the efficacy of one of the concepts that lies behind the proposal, which is to try to adjust the metrics and the oversight to the relative liquidity of the markets for the particular assets. So, for example, in the exceptions for underwriting and market making, it will be appropriate to evaluate what a firm does differently if it is making a market in a relatively less liquid asset, which, for example, could be a bond in a smaller firm, as opposed to making a market in Fortune 500 equities that are traded on the New York Stock Exchange.

So we will try to minimize the effect upon liquidity in markets by implementing the market-making and underwriting sections as sensibly as we can, taking account of the differences in markets. I do not know what 3 or 4 or 5—well, it will surely be more than that because the rule will not take effect for another 2 ½ years, but what 5 or 6 or 7 years from now, how the nature of trading in these instruments will have changed. It may well be that a bunch of it just migrates to some different firms.

Chairman JOHNSON. Senator Hagan.

Senator HAGAN. Thank you, Mr. Chairman, and thank you for holding this Committee hearing.

Governor Tarullo, in your written testimony, you devoted much of your discussion to capital regulation after Dodd-Frank. I agree that this is an issue of utmost importance. European banks currently hold large portfolios of sovereign debt that would satisfy liquidity coverage ratios under Basel III. Yet we have seen declines in the liquidity and value of these assets. It has been reported that

the Basel Committee may add equities and corporate debt to the list of assets that can be used to satisfy the liquidity requirements.

Could you discuss this possibility? Would you agree that banks are best served by holding a diverse pool of "high-quality liquid assets" such as cash, U.S. Treasurys, covered bonds, and central bank reserves?

Mr. TARULLO. Certainly, Senator. I should say at the outset that the interest in taking another look at the liquidity coverage ratio began well before the current period of stress on European sovereigns. We, which is to say, the Federal Reserve, was one of the entities which asked internationally to take another look at the liquidity coverage ratio, and I would say, to be fair to those who came up with the original proposal, it was in large part because we had never had quantitative liquidity requirements before, either nationally or internationally, and so we, that is to say, the Board, thought that it was particularly important that, before putting any such requirement in place, there be a pretty close look and a look that involved principles at central banks and regulators.

One of the precepts, I think, for the renewed look was just the point that you were making, that if you are worried about the liquidity of a firm, what you are really asking is how well are the liabilities and the assets of that firm matched so that in a period of stress it can cover its needs over some period of time so that it has a plan, it can develop a plan for longer-run survival. And what I had thought was that the 2008 period gave us a very good real-life experiment to test what kinds of instruments actually do remain liquid even during a period of stress like that, for example, highly traded equities of large companies.

So that is, in fact, one of the motivations for the rethink, and I believe that once the international group at the Basel Committee that is looking at the LCR has finished its evaluation next year, you will see some changes in things like what qualifies and assumed run rates and the like to try to conform the requirements somewhat more closely to the experience we actually had in late——

Senator HAGAN. Let me follow up on that. The Volcker Rule provides an exclusion for accounts used to establish or acquire a position for the purposes of the bona fide liquidity management.

Mr. TARULLO. Right.

Senator HAGAN. And I would expect that the Basel Committee's definition of the bank's stock of liquid assets for liquidity coverage ratio purposes and the trading account exclusion for bona fide liquidity management would be closely linked. Is that an appropriate expectation?

Mr. TARULLO. Well, I think for certain we would want to take the revised liquidity coverage ratio into account in thinking about what is a legitimate liquidity management program. But, remember, the LCR is only a 30-day window, and if you are looking at sound liquidity management for a firm, 30 days is important because of that breathing period that I mentioned a moment ago, but you actually want to make sure that the book is better matched going well out beyond 30 days.

So while we would take LCR into account, good sound liquidity management will include things other than just the LCR.

Senator HAGAN. Thank you.

Chairman Schapiro, the proposed Volcker Rule prohibits a banking entity from acquiring an ownership interest in, or sponsoring a "covered fund" unless otherwise permitted under the rule. I was hoping to clarify certain aspects of what constitutes a covered fund.

Would the "covered fund" definition apply to foreign funds such as mutual funds or other regulated collective investment vehicles offered to U.S. investors?

Ms. SCHAPIRO. Senator, it is a little hard to answer that straightforwardly, but I will try to. We started, when we—first of all, working very closely with our colleagues in the bank regulatory world because at the end of the day this rule is really about protecting the safety and soundness of the banks as a result of their investment or sponsorship. So we started with a statutory provision given to us by Congress, which was really quite broad, and then we worked to try to determine where that breadth was over-inclusive and actually in some instances under-inclusive, and came up with what we thought was a pretty tailored definition.

I think comments are going to be critically important to us in refining this so that we come up with a meaningful definition that does not create gaps and loopholes but is also, as I said, not over-inclusive.

We did propose to include—and the CFTC may want to speak to this—commodity pools and foreign funds because we thought that was an area where there ought to be coverage. We have gotten a lot of pushback on those issues, and so we will be reviewing those comments very, very carefully.

Senator HAGAN. I was relieved to see that a joint venture between a banking entity and an "operating company" would still be permitted under the rule. However, to my knowledge, the term "operating company" remains undefined. Given that joint ventures are not the type of corporate structures that the Volcker Rule was intended to cover, I would expect that definition to be broad. Can you comment on what is meant by the term "operating company"?

Ms. SCHAPIRO. Just to say that that is actually an example where we thought the statute was over-inclusive, and so we sought to create exemptions there for joint ventures that are operating companies or vehicles that are used to merge an entity with or into a banking entity or its affiliates. I understand that there are those who feel that we did not make those exclusions broad enough, and so we are looking at that.

Senator HAGAN. And then one final thing under that question. I noted that credit funds that originate and invest in loans and other extensions of credit on a long-term basis were not exempted from the covered fund definition. Would you agree that credit funds allow the banking system to share credit risk with investors?

Ms. SCHAPIRO. Well, I think, again, that is something—I do not have a good answer for you on that, but, again, we will be sure we look at that carefully. All of these issues around covered funds are obviously complex and technical, but that is why the comments will be very valuable to us, as well as the input from our colleagues who regulate the banks.

Senator HAGAN. OK. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Vitter.

Senator VITTER. Thank you, Mr. Chairman. Thanks to all the witnesses.

Like a lot of folks, I have a broad concern with the notion of SIFIs and regulation of that, and the general concern is that in trying to deal with too big to fail in this way, we are going to end up encouraging or incenting too big to fail. Specifically, just as an example, the Wall Street Journal has reported that the biggest too-big-to-fail banks pay about 78 basis points less for their funds than their rivals.

Has that sort of factor in the market been examined in terms of the SIFI issue? What will be the impact of designating these nonbanks as systemically important in the market? And is there going to be the consequence that some of them actually gain advantage? Has that been examined in a rigorous way?

Mr. TARULLO. I think you are addressing me, Senator?

Senator VITTER. I guess I would love your reaction, Governor, as well as Secretary Wolin's.

Mr. TARULLO. OK, so let me start. I think with respect to too big to fail, it is not a binary exercise; that is, one does not go from being perceived as clearly too big to fail one day to being perceived clearly not too big to fail the next day. And I think what you have heard today and probably have heard on past panels is a process that is in place to try to change in a real way the perception of too big to fail among systemically important institutions in the United States. And that happens, first, through the kinds of capital standard that I was describing earlier. I think, second, it happens through making market discipline real for these institutions.

When the FDIC is able to develop, as it is in the process of doing, a credible liquidation authority, what you begin to see, as I think you have probably observed, outsiders, including ratings agencies, saying there is not the level of implicit support that they had imputed to U.S. firms in the past any longer, and that has actually laid behind some of the downgrades that the ratings agencies have done. They have said explicitly this is not about the condition of the bank; it is just what we think—how much we think the Government would stand behind them.

So we absolutely look at market indicators to show us to what degree market discipline is becoming a reality for these firms in the same way that it is a reality for a middle-sized regional bank in the Midwest.

Senator VITTER. Secretary?

Mr. WOLIN. Senator, I would just add this thought to what Governor Tarullo said, which is that no one is lining up to be designated as a SIFI—those who might be designated lining up, quite displeased with the prospect, and that is because it comes with a set of enhanced prudential standards that they will have to meet. And, you know, it ties in to what the Governor was saying, I think, with respect to how we think about what the ultimate implication of this is, more buffers, more standards, and so forth.

So I do not think being designated as a SIFI is something that people see as an advantage either with respect to cost of funding or otherwise. It will come with sort of a more onerous set of requirements.

Senator VITTER. OK. Thank you. And just one other comment about a completely separate topic to the Chair of the SEC, Chairman Schapiro. First of all, the Stanford case, as you know, has been very important to me because of the number of Louisiana victims. Senator Shelby is in a similar situation. A lot of folks are affected. The SEC did take action in June, and I thank you for that. It was very long in coming, going back to well before your tenure, but the SEC finally took positive concrete action. I thank you for that.

You have been personally very engaged since then to try to get SIPC to do the right thing and act, and we have had many conversations about it. And I also thank you for that, and I am sincere about both of those things.

Having said that, this again is dragging on 6 months after your positive concrete action, and so I would just encourage you publicly, the same way I have encouraged you privately, that I think the SEC needs to take definite action again before the end of the year in a positive way. And I am afraid that is going to mean suing SIPC. It seems to me that is what is going to be required based on my information and my conversations. I hope there could be another more positive and immediate outcome, but bottom line, I really encourage you in the strongest possible terms to make sure to take the next step, definite action before the end of the year.

Ms. SCHAPIRO. Senator, I appreciate that, and I think you know I share deeply your concern about this and that we not take longer than is absolutely necessary, and that we try to get to the best possible result for the victims. That is what we are working very hard on, and the Commission is equally engaged in getting to resolutions as quickly as we possibly can.

Senator VITTER. Thank you.

Chairman JOHNSON. For the past few minutes, there has been a vote pending in the Senate. Senator Shelby has some quick questions.

Senator SHELBY. Thank you, Mr. Chairman.

To the SEC, Chairman Schapiro, your tenure as the Chairman of the SEC has been marked by a number of major failures. These failures include investor protection failings that was just brought up, Stanford; failures in court like the recent Citicorp settlement decision; rulemaking failures like the proxy access rule that was rejected by the D.C. Circuit. There have also been operational failures like the Commission's lease of the Constitution Center; management failures like your general counsel's involvement in the Madoff case; and the continuing internal control failures identified by the GAO, the Government Accountability Office.

As head of the SEC, do you take responsibility for any of these failures? Does the buck stop with you? Or what do you say?

Ms. SCHAPIRO. Well, Senator, let me start by saying that the GAO found that the SEC had no material weaknesses in its internal controls over financial reporting this year for the first time in years. The agency's issues with respect to internal controls have gone on through many Administrations, but we cleared both material weaknesses this year. I am extremely proud of that and extremely proud of the staff's work.

The agency has had some stumbles. I have always taken responsibility for being transparent about them and for fixing them going forward. But I think your recitation ignores the unbelievable amount of great work that has gone on at the SEC in the last 3 years, including the fact that we had a record year in enforcement last year, more enforcement cases filed than ever before in the history of the agency, more rulemakings successfully completed, more rulemakings successfully completed through unanimous votes by the Commission than in a very long time. And we have worked hard to remedy many issues that have been of longstanding concern at the agency. I do take responsibility. I testify often about them. But I am enormously proud of this agency's record.

Senator SHELBY. Secretary Wolin, your opening statement gave the impression to some of us that nonbank lenders are completely unregulated. Of course, you know that is not totally true. Explain to the American people how these lenders are currently regulated at the State level and also by the Federal Trade Commission.

Mr. WOLIN. Senator Shelby, I would say they are substantially unregulated for consumer protection. They are, depending on the State and depending on what kind of nonbank financial firm it is, regulated in States. But I would say that what we have now is no Federal regulator who is focused on the nonbank financial sector with respect to consumer protection in a serious way, and that, of course, leaves an unevenness as between banks and nonbanks.

Senator SHELBY. Are you at Treasury and on behalf of the Administration, are you guys—Senator Corker brought it up—are you seriously interested in talking to the Republican leadership about how we can move forward on the consumer protection head and all of this? In other words, we have submitted three recommendations to you, one of which he brought up, Senator Corker, dealing with the Treasury's initial recommendation that this consumer agency be accountable, that it have a board and so forth. Are you guys seriously interested in trying to negotiate with us on this and let us move forward where we can regulate a lot of these nonbank banks?

Mr. WOLIN. Well, I think, Senator, what we are very interested in is the Senate considering Richard Cordray. As you know, the statute provided a very intricate set of protections, checks and balances with respect to the CFPB. It has gotten oversight by this Congress, by the GAO, independent audits, reporting requirements. Its rules are subject to coordination with the regulators to my left. It can be overturned by a vote of the FSOC. There are a whole set of things there that, in the end, Congress determined were the right governance structures for this entity, and we think that, having done that, it is important for the Senate to consider the President's nominee.

Senator SHELBY. Sure. One last question, Mr. Chairman. Just to go back to Chairman Gensler. You were involved in crafting the Dodd-Frank legislation. You testified at many hearings, crafted statutory language, and attended countless meetings. You even sat at the table during the Agriculture Committee markup and staffed members into the early morning hours during the conference.

Since the passage of Dodd-Frank, you have testified numerous times against changes to Dodd-Frank and have been to Europe many times to lobby their regulators. In fact, according to your

written testimony, you will be meeting with foreign regulators on Thursday.

Chairman Gensler, in all candor, do you not think that if you had spent less time protecting your political turf, your regulatory turf, and more time protecting customers and overseeing firms like MF Global, it is less likely that MF Global would be where they are today and the customers' money would not be missing?

Mr. GENSLER. Senator, I think it is about protecting the American public. It is what the CFTC does every day prior to Dodd-Frank and after Dodd-Frank. It is about ensuring that end users and their customers get the benefit of these markets to hedge a risk, lock in a price and do what they do well. We are an agency that relies heavily on self-regulatory organizations. We are only 10 percent larger than we were in the 1990s, and that is——

Senator SHELBY. But making you larger does not make you better, does it?

Mr. GENSLER. Not necessarily. Absolutely. We agree on that.

Senator SHELBY. Mm-hmm.

Mr. GENSLER. We have to be more efficient——

Senator SHELBY. Mm-hmm.

Mr. GENSLER.——use technology better——

Senator SHELBY. Sure.

Mr. GENSLER.——use the collaborative process with other regulators here and around the globe, enter into memorandums of understanding, having mutual recognition with those international regulators. We are a small regulator that has to leverage, really, off of the self-regulatory organizations and other regulators, but I think that the hard working staff at the CFTC is there, and as Chairman, I do take responsibility for those things that do well and those things that do poorly. I do take responsibility and this job seriously, sir.

Senator SHELBY. Do you believe that the CFTC has failed the American people as far as MF Global is concerned?

Mr. GENSLER. Again, I am not participating in the matter, but let me answer it more generally.

Senator SHELBY. Well, you can——

Mr. GENSLER. If people——

Senator SHELBY.——answer it specifically——

Mr. GENSLER. No, no, I think——

Senator SHELBY. Have they either failed it or they have not? Obviously, they have failed.

Mr. GENSLER. I think that—I think that when our legal system says to segregate funds, it means to segregate funds, and customers need to be able to rely on that every day from every firm.

Senator SHELBY. And if people have not done it, they should pay the consequences?

Mr. GENSLER. Well, that is what our law says, sir.

Senator SHELBY. When they break rules and laws.

Mr. GENSLER. That is what our laws say.

Senator SHELBY. Thank you. Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you all for your testimony and for being here with us today.

Shortly, the Senate will take another significant vote to ensure that American consumers, including servicemembers and older

Americans, have the strong consumer protections that they want, need, and deserve. I urge my colleagues to not let politics trump the needs of American consumers and stop any filibuster on Richard Cordray's nomination to be the first Director of the Consumer Financial Protection Bureau. Mr. Cordray is an extremely well qualified candidate who deserves a vote on his nomination.

Thank you all for your hard work, continuing to implement the Wall Street Reform and Consumer Protection Act.

This hearing is adjourned.

[Whereupon, at 12:13 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF SENATOR SHERROD BROWN

Thank you, Mr. Chairman, and thank you for holding this hearing and for your commitment to the Committee's oversight role.

At a June Subcommittee hearing, representatives from the three banking regulators shared the lessons that they learned from the financial crisis. They also described the steps that they are taking to reform the financial system.

But I find several recent regulatory actions troubling.

In particular:

- The major bank-holding companies have **transferred significant portions of their derivatives** exposure into their bank subsidiaries that are backed by the Federal Government; and
- The Federal Reserve provided $7.7 trillion **in secret, low-cost loans—**unknown to both Treasury and Congress—to financial companies, particularly the six biggest megabanks.

These examples clearly demonstrate three things:

First, we need **more transparency.**

Certainly some trade secrets need to be protected, but the lack of transparency that exists in the financial sector is paralleled perhaps only by our national security establishment.

Dodd-Frank took some steps in this direction, but we need to do more.

Second, regulators, the Treasury Department, and Congress are **far too lenient** with a Wall Street that they view as more essential than it actually is.

Preventing excessive risk-taking and moral hazard requires significant costs and reforms for any institution seeking support from the U.S. Government, and by extension the taxpayers.

As both Governor Tarullo and Senator Shelby have argued this includes more equity at the biggest megabanks—a sentiment that I know some other panelists might disagree with.

Third, not enough has been done to **help those outside of the financial sector—**most especially the middle class on Main Street.

Many in Ohio and around the Nation are hurting—families and businesses, students and seniors.

Daily, we are reminded of the inadequacy of the response to the financial crisis. This failure to fight for middle class Americans is all that much starker when we view it against the gifts that have been bestowed upon Wall Street.

The result is a system that is good for the **regulated institutions,** but bad for **policymakers, investors and other market participants,** and **taxpayers.**

One of the central lessons of the financial crisis is that terrible things can happen when institutions are allowed to run wild—free from **oversight or accountability.**

So far, I'm sorry to say that the regulators' deeds have not necessarily matched their words.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF SENATOR JERRY MORAN

While today's hearing is intended to review the financial stability of the United States, I believe it is critically important that we also take this opportunity for a basic review of the facts in the collapse of MF Global. Kansans are rightfully frustrated. Many have lost their confidence in the markets and in Government as funds that were legally required to be segregated have seemingly been stolen from the firm. I strongly urge this Committee to consider a series of hearings to specifically investigate the failure of MF Global and to identify solutions which can restore confidence.

Additionally, I would hope today's hearing could provide an opportunity to debunk the myth that Senate Republicans are standing in the way of improved consumer protection. The commitment and request made by 45 Senators remains the same today as it did 7 months ago: no confirmed Director, regardless of party affiliation, until basic changes are made to the structure of the CFPB. I have had a legislative proposal pending in the Senate since April which would accomplish our goals for reform. Nothing I have proposed is radical; in fact it is based on returning the CFPB to the President's original design and funding mechanism. Our collective time and energy would be better spent working on a solution which can bring accountability to the Bureau rather than a doomed vote which does nothing to advance our reform efforts or protect consumers.

This rhetoric we will witness this week may grab headlines, but it ignores a basic fact: accountability and transparency at the CFPB is a goal that should be shared by every policymaker interested in protecting consumers from the abuses of the past.

Even if the President decides to change course and constructively engage with the Senate in quickly passing some basic reforms to the structure of the agency, the CFPB will remain an incredibly powerful Government bureaucracy. Nothing I have proposed would undue those authorities or responsibilities. My concern, however, is that without additional transparency and accountability, the result of a poorly drafted rule could lead to less credit and less opportunity for consumers and small businesses alike.

PREPARED STATEMENT OF NEAL S. WOLIN

DEPUTY SECRETARY, DEPARTMENT OF THE TREASURY

DECEMBER 6, 2011

Chairman Johnson, Ranking Member Shelby, and Members of the Committee, thank you for the opportunity to discuss Treasury's progress implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act).

The Dodd-Frank Act is the strongest set of financial reforms enacted since the Great Depression, and was passed in the wake of the worst financial crisis this country has experienced since that time.

That crisis cost nearly nine million jobs, wiped out more than a quarter of household wealth, and deeply compromised Americans' trust in our financial system.

Today, our country's foremost challenge is helping the millions of Americans who lost their jobs as a result of the recession find new employment. Nearly three million private sector jobs have been created within the last 2 years, but our economy is not creating new jobs fast enough.

Congress took an important first step by passing important provisions of the President's American Jobs Act that provide tax cuts for hiring unemployed or service-disabled veterans and repeal a tax on Federal contractors. It should pass the remainder without delay. Independent economists estimate that the provisions in the American Jobs Act, taken together, would create up to two million new jobs and add nearly 2 percentage points to economic growth next year.

At the same time as we work to create jobs, Treasury is focused on implementing the Dodd-Frank Act to build a more efficient, transparent, and stable financial system—one that supports this country's long-term economic strength and leadership, rather than jeopardizes it.

Congress designed the Dodd-Frank Act's reforms to address the key failures in our financial system that precipitated and prolonged the financial crisis. Its core elements include:

- *Tougher constraints on excessive risk-taking and leverage.* To lower the risk of failure of large financial institutions and reduce the damage to the broader economy if a failure occurs, the Dodd-Frank Act provides authority for regulators to impose more conservative limits on risks that could threaten the stability of the financial system.
- *An orderly liquidation authority to protect taxpayers.* The Dodd-Frank Act creates a new orderly liquidation authority to break up and wind down a failing financial firm so that taxpayers and the economy are protected.
- *Comprehensive oversight of derivatives.* The Dodd-Frank Act creates a new regulatory framework for the over-the-counter (OTC) derivatives market to increase oversight, transparency, and stability in this previously unregulated area.
- *Stronger consumer protections.* The Dodd-Frank Act created the Consumer Financial Protection Bureau (CFPB) to concentrate authority and accountability in a single Federal agency for consumer financial products and services.
- *Increased transparency and market integrity.* The Dodd-Frank Act includes a number of measures that increase disclosure and transparency in financial markets, including new reporting rules for hedge funds, trade repositories to collect information on derivatives markets, and improved disclosures on asset-backed securities.
- *Accountability for stability and oversight across the financial system.* The Dodd-Frank Act created the Financial Stability Oversight Council (the Council) to identify risks to the financial stability of the United States, promote market discipline, and respond to emerging threats to the stability of the U.S. financial

system. To support the Council, the Office of Financial Research (OFR) collects and improves the quality of financial data and develops tools to evaluate risks to the financial system.

Our current economic challenges only increase our commitment to meeting our responsibility to the American public to implement these reforms fully, quickly, and carefully. As the President has said, "We have a responsibility to write and enforce these rules to protect consumers of financial products, taxpayers, and our economy as a whole . . . History cannot be allowed to repeat itself."

Going forward, the Dodd-Frank Act aims to mitigate the effect of future stresses in the financial system on our economy and provides the Government with new tools in times of crisis. It aligns the boundaries of our regulatory structure with the risks presented by our modern-day financial system. It restores the balance between innovative financial markets and financial stability. And it meets our responsibility to the American people to learn the lessons of this crisis, and to act upon them.

* * *

Implementation Principles

Several key principles continue to guide our implementation of the Dodd-Frank Act.

1. Balancing Speed with Quality and Consistency

Treasury and the independent regulatory agencies responsible for writing most of the Dodd-Frank Act's rules are working to provide clarity to the public and the markets as quickly as possible.

However, a regulatory system that addresses the substantial flaws that led to the financial crisis should not be built in haste. The Dodd-Frank Act is designed to help protect our economy for generations. Many of its reforms involve some of the most complex areas of finance.

As a result, Treasury and the independent agencies are committed to balancing speed and certainty with adequate time for broad public engagement and dialogue, coordination among U.S. regulators and our international counterparts to help achieve a level playing field, and analyses of costs and benefits to help ensure rules build a stronger, more resilient financial system without placing unnecessary burdens on industry.

Substantial progress has been made since the Dodd-Frank Act was passed less than 18 months ago. Since July 2010, financial regulators have publicly proposed or finalized nearly all the major rules related to the core elements of reform. The ultimate shape of both individual requirements and overall reform is becoming clearer by the week. Increasingly, financial firms are in a position to adjust their business models in anticipation of final rules.

Rules proposed or finalized include:

- the Volcker Rule;
- rules for designating nonbanks and financial market utilities for enhanced supervision and prudential standards;
- rules governing the orderly resolution of large failing financial firms;
- the majority of OTC derivative market regulations;
- risk retention requirements;
- reporting requirements for large hedge fund and private equity funds;
- and rules enhancing protections for investors.

Treasury will continue to work with the independent regulators in pursuit of final rules that are both timely and fully considered.

2. Transparency and Public Engagement

An open and ongoing public dialogue is critical to the rule-writing process. Regulators have gone above and beyond statutory requirements to engage broadly with interested parties prior to issuing proposed rules, review and consider comments on proposed rules carefully, and pursue public rulemakings in cases where the Dodd-Frank Act does not require them, such as with respect to the process for the designation of nonbank financial companies.

Over a year ago, the Financial Stability Oversight Council released an integrated Dodd-Frank Act implementation roadmap to provide the public with a general guide to the rule-writing agencies' anticipated timelines and sequencing for the implementation of Dodd-Frank Act rules. Many of the Council's member agencies have pro-

vided the public with notice of anticipated rulemaking timelines significantly in advance of the rulemaking activity itself.

To bolster their efforts, the Council has also made available on its Web site links to each member agency's Dodd-Frank Act implementation Web page, providing the public with a single portal to updated agency timelines, proposed rules, key studies, final rules, public comments, and other implementation materials.

Through the comment process and public forums, member agencies have also sought the public's input on how rules interrelate and how, and in what sequence, they can best be implemented. Agency efforts have included sponsoring multi-agency public forums, including SEC and CFTC joint roundtables regarding implementation of derivatives reform, to hear the public's views on the substance and implementation of rules involving parallel or overlapping issues.

Transparency and public input informs and strengthens the reform process, helping to ensure new rules foster healthy and dynamic markets. Treasury will continue to encourage and prioritize maximum transparency and public engagement as reform moves forward.

3. Strengthening Coordination

Strong coordination is essential for implementing the Dodd-Frank Act in a way that creates a coherent, efficient, and effective financial regulatory system. Coordination is important for closing gaps and minimizing opportunities for regulatory arbitrage, which could leave the U.S. and global financial system more vulnerable to future crises. Coordination is also important to avoid overlapping or conflicting regulations that may create inefficiencies or unnecessary compliance burdens within the financial industry.

The Dodd-Frank Act provides for coordination of various kinds and with various degrees of specificity. One of the duties of the Financial Stability Oversight Council is to facilitate information sharing and coordination among its independent member agencies, both during the implementation of the Dodd-Frank Act and as it carries out its broader responsibilities.

Congress granted specific authority to the Secretary of the Treasury, as the Chairperson of the Council, to coordinate the work of the agencies on two important Dodd-Frank rulemakings: the Volcker Rule, which limits banks' ability to take excessive risks, and the risk retention rule, which improves the alignment of incentives among financial institutions involved in securitization.

Congress did not provide Treasury or the Secretary of the Treasury, as Chairperson of the Council, the authority to force coordination among its independent member agencies. Yet even without this authority, Treasury is encouraged by the efforts the Council's member agencies have made over the past 18 months, and their unanimous recognition of the importance of coordination, even when not statutorily required, in the Council's first annual report.

Treasury, along with the Council's other member agencies, is committed to going beyond the coordination requirements in the Dodd-Frank Act, and will continue to seek opportunities to improve and increase coordination going forward.

4. Working Toward Simple, Streamlined, and Balanced Reform

As Dodd-Frank implementation moves forward, Treasury believes that it is important for agencies to streamline, simplify, and consider the economic effects of significant rulemakings. Implementation must strike the right balance between shaping a financial system that is safer and more resilient and one that is innovative and dynamic. Analyzing new regulations' costs and benefits, both in terms of individual rules and rules in the aggregate, is an important part of getting the balance right.

The Dodd-Frank Act made several important institutional changes to help streamline regulations and the regulatory process more broadly. It consolidated prudential supervision of federally chartered depository institutions by folding the Office of Thrift Supervision's prudential responsibilities into the Office of the Comptroller of the Currency's mandate. It created the Consumer Financial Protection Bureau, which is now responsible for rulemakings under Federal consumer financial protection laws that were previously spread among seven Federal agencies. It also created the Financial Stability Oversight Council in part to facilitate information sharing and strengthen coordination among its member agencies.

In addition to these institutional reforms, agencies have also made efforts to streamline supervisory requirements and new regulations as the rule-writing process moves forward. Last week, the CFPB requested public input on ways to streamline regulations under the consumer financial protection laws that it has inherited from seven Federal agencies. The CFPB is asking the public to identify provisions that it should put the highest priority on updating, modifying, or eliminating, and

is also seeking suggestions for making compliance easier for firms, especially smaller ones.

Another example is last month's joint statement from the CFPB, along with the Federal Deposit Insurance Corporation, Federal Reserve Board, Office of the Comptroller of the Currency, National Credit Union Administration (together, the prudential regulators). The statement provided greater clarity regarding how the agencies expect to carry out supervisory and enforcement responsibilities with respect to consumer protection. Since the prudential regulators oversee compliance with Federal consumer financial laws for depository institutions and credit unions with assets below $10 billion, while the CFPB oversees all institutions above that limit, the agencies jointly agreed on common standards and intervals for measuring financial institutions' asset sizes and determining supervisory authority.

The CFPB has also begun carrying out its mission to streamline and simplify rules and requirements with regard to consumer financial products and services. One of its first initiatives was to combine two federally required mortgage disclosure forms into one clear, simple document. The CFPB is currently soliciting public feedback on two potential designs, while also working with the Department of Education to develop a straightforward new form for colleges and universities to use to communicate student aid offers.

As new rules are designed to strengthen our financial system, the Administration is leading a Governmentwide effort to streamline, simplify, and review the costs and benefits of new and existing regulations. In January, the President issued an Executive Order directing executive agencies to develop a plan to streamline regulations, including carrying out a review of existing regulations and assessing the costs and benefits—both qualitative and quantitative—of any new rules or requirements. In June, Secretary Geithner requested independent member agencies of the Financial Stability Oversight Council to adopt the principles and guidelines of the President's Executive Order. In July, the President issued a second Executive Order encouraging all independent regulatory agencies, to the extent permitted by law, to follow the key provisions of the January order, including eliminating or fixing rules that are outdated or unjustifiably costly, and making sure that new regulations undergo vigorous review. The President asked that they publish written plans describing their efforts within 120 days.

All independent agencies, including those responsible for Dodd-Frank Act rulemakings, are expected to submit plans, and many have already done so. The Federal Reserve, for example, is increasing efforts to review all regulatory matters from the perspective of community depository organizations, alongside regular zero-base reviews of its regulations roughly every 5 years. In addition to its ongoing review of rules affected by the Dodd-Frank Act, the FDIC is also undertaking a community bank initiative that includes a review of its examination process and rulemaking process to further our understanding of the challenges and opportunities for community banks. The CFTC has also submitted a plan describing its efforts, and is examining and revising a number of existing regulations as part of its implementation of the Dodd-Frank Act. It plans to begin periodic, retrospective reviews of regulations not reviewed as part of the Dodd-Frank Act work as soon as that work is complete.

In their plans, independent agencies have stressed the importance of understanding the costs and benefits of new rulemakings, their methods for doing so, and their compliance with statutes designed to ensure that regulatory agencies consider and minimize regulatory burdens.

However, it is important to ensure that analyzing the costs and benefits of reforms is balanced with their full and timely implementation. As reform moves forward, we should not lose sight of the continuing costs of the financial crisis this country experienced—millions of jobs, trillions of dollars, and countless lost opportunities—or the potential costs of stalled or incomplete reform on our economy in the future.

5. Building a Level Playing Field for Strong Global Reform

Through the G–20, the Financial Stability Board, and regular bilateral engagement, the United States continues to lead and foster consensus on key areas of financial reform to help strengthen global financial stability, build more resilient financial markets, and promote greater consistency and convergence in regulatory outcomes.

In 2009, the G–20 leaders agreed to a set of objectives in pursuit of a stronger and more internationally consistent supervisory and regulatory framework. Among other issues, the G–20 leaders pledged to reshape their regulatory systems to identify and take account of macroprudential risks; to extend regulation and oversight to all systemically important financial institutions, instruments and markets; to

work to improve the quality, quantity, and international consistency of capital in the banking system; and to create greater transparency and alignment in frameworks for OTC derivatives.

Between the G–20 meetings in London and Pittsburgh in 2009 and last month's meeting in Cannes, notable progress has been made with our counterparts around the world on these and other issues critical to global financial stability.

Following the G–20 leaders call at the Pittsburgh Summit, in 2011 regulators reached agreement on the new Basel III framework for bank capital and liquidity that is designed to allow institutions to absorb a level of losses comparable to what we faced at the peak of the financial crisis without turning to taxpayer support. These heightened standards phase in gradually, so that banks can adjust while continuing to provide credit to households and businesses. Basel III will also help to ensure that the level and definition of capital will be uniform across borders, and for the first time, outlines mandatory leverage and liquidity ratios.

At the Cannes Summit, the G–20 leaders endorsed measures to address challenges posed by global systemically important financial institutions. These measures include requirements for higher loss absorbency capacity, new tools to facilitate orderly resolution, and more intensive and effective supervision. The largest firms will be required to hold additional capital buffers to reduce the risks of potential disruptions caused by the failure of one of these firms.

In addition to international work on systemically important firms, G–20 leaders have also adopted principles aligned with the Dodd-Frank Act to promote international consistency across derivatives markets. These principles are fully consistent with those included in the Dodd-Frank Act.

Two years ago in Pittsburgh, the G–20 leaders reached agreement on requiring increased clearing, trading on exchanges, and reporting for over-the-counter trade. In Cannes, the G–20 leaders also agreed to pursue a U.S. proposal for a new global margin standard on uncleared derivatives trades to create uniform incentives for central clearing, while also pushing forward on efforts supported by policymakers and industry alike to develop an international legal entity identifier system, which will help precisely identify parties to financial transactions. That is important, for example, for trading in derivatives, where it will help shine a spotlight on counterparty exposures and thus interconnectedness, a key factor in assessing threats to financial stability. These efforts are critical to ensure international coherence and greater oversight of capital markets. Treasury is working with our G–20 counterparts to synchronize implementation.

As the world's leading economy, financial reform in the United States should set a strong, clear example for the international community. Treasury will remain committed to fully implementing the Dodd-Frank Act at home, while working with our counterparts around the world to strengthen global reform.

* * *

The Dodd-Frank Act made Treasury responsible for standing up several important new institutions to help ensure our financial system is stronger and more resilient going forward. In addition to the Consumer Financial Protection Bureau and the Financial Stability Oversight Council, the Dodd-Frank Act created an Office of Financial Research (OFR) to provide the Council with critical data and analytical support. The Dodd-Frank Act also created the Federal Insurance Office (FIO) to identify gaps in regulation that could contribute to a systemic crisis in the insurance industry or the financial system more broadly.

Treasury has worked hard to stand up these important new institutions, and is pleased with the progress they have made.

The Consumer Financial Protection Bureau

The CFPB's mission is to help ensure consumers have the information they need to make financial decisions appropriate for them, carry out Federal consumer financial laws, and restrict unfair, deceptive, or abusive acts and practices. The Dodd-Frank Act created the CFPB to consolidate consumer protection responsibilities for consumer financial products and services that had been fragmented across several Federal regulators into a single institution dedicated solely to that purpose.

In July, President Obama nominated Richard Cordray to be the CFPB's first director. He is exceptionally qualified to lead the CFPB. Throughout his career, Mr. Cordray has demonstrated a strong commitment to consumer advocacy and public service, and possesses a deep understanding of both finance and consumer protection law.

Despite Mr. Cordray's outstanding qualifications, some in the Senate have said they will not confirm any individual to head the CFPB without fundamental changes to its structure, which Congress laid out in the Dodd-Frank Act.

Secretary Geithner has urged Senators to reconsider their view. During his last appearance before this Committee, the Secretary asked that Senators who have not done so meet with Mr. Cordray and learn more about the work of the CFPB. As Senators get to know Mr. Cordray, we believe they will find that he is an ideal candidate to lead the CFPB, and that his measured, sensible approach to the CFPB's work will allay concerns some Senators have expressed regarding the CFPB's operation in the future. Furthermore, the CFPB is subject to strong oversight through statutorily required hearings, reports, and audits, constraints that do not apply to any other Federal banking regulator, and is the only banking regulator with a statutory cap on its primary source of independent funding.

Without a Director, the CFPB's ability to address unfair, deceptive, and abusive practices by payday lenders, private student loan providers, debt collectors, and other nonbank lenders, including certain mortgage originators and servicers, is constrained. It also limits the CFPB's ability to level the playing field so that banks and nonbanks play by the same rules, and to prevent the sort of imbalances in consumer finance markets—in particular, mortgage loans—that helped cause the financial crisis.

If the CFPB is unable to exercise its full authority, not only will consumers lack common-sense protections, but our economy will remain vulnerable to some of the same critical gaps in regulation that helped cause the financial crisis.

Under its current authority, in July the CFPB assumed responsibility for supervising depository institutions with over $10 billion in assets and their affiliates. In October, the CFPB released its supervision and examination manual, which is the field guide that examiners will use in supervising both depository institutions and other consumer financial services providers. The CFPB and prudential regulators also agreed on common standards for measuring an institution's asset size for purposes of determining supervisory authority.

In its supervision and examination manual, the CFPB highlighted its Mortgage Servicing Examination Procedures and recognized the pervasive problems reported in the mortgage servicing industry. As reported by prudential regulators, servicers lost important documentation, experienced problems with foreclosure processing, and failed to communicate with consumers—and, in some cases, borrowers who qualify for loan modifications did not received them in time to avoid foreclosure. Initially, the CFPB's examinations of mortgage servicers will focus on the servicing of loans in default.

In November, the CFPB also outlined plans to provide advance notice of potential enforcement actions to individuals and firms under investigation for violating Federal consumer financial laws. The EarlyWarning Notice process allows the subject of an investigation to respond to any potential legal violations before the CFPB decides whether to begin legal action.

The CFPB also created the Know Before You Owe project to simplify the disclosures that consumers receive. Know Before You Owe has already launched initiatives simplifying mortgage disclosure requirements and student aid offers, and will include additional initiatives in other areas of consumer finance in the future.

The Know Before You Owe mortgage disclosure initiative combines two lengthy, complicated federally required mortgage disclosures into a single, simpler form that clearly presents costs and risks to borrowers. The CFPB is currently evaluating two potential forms, which they have posted on their Web site to gather public input, as well as conducting one-on-one interviews with consumers, lenders, and brokers.

The Know Before You Owe's student aid project aims to help young people more easily understand and compare the costs and benefits of student loans. The CFPB partnered with the Department of Education to create a model format that schools can use to communicate financial aid offers. Currently, these offers are often difficult to understand and compare, and may not clearly differentiate loans from other types of student aid. The CFPB has also launched an online guide to help borrowers understand their options when repaying student loans, and recently requested that they share their experiences using private student loans to improve our understanding of this particular credit market.

Credit card applications also include confusing language and fine print, which makes it difficult for consumers to fully understand the terms of these agreements. Last week, the CFPB released a report that highlighted the Bureau's success assisting consumers with credit card complaints. Very soon, the CFPB plans to launch a new initiative under the Know Before You Owe Project to help consumers better understand these agreements and make more informed decisions.

The CFPB is also committed to helping ensure that members of the armed services and their families are fully informed and empowered when choosing consumer financial products and services. Servicemembers and their families face special circumstances—deployments, relocations, overseas assignments—that present unique

challenges. To better understand the nature of these challenges, the CFPB's Office of Servicemember Affairs is collecting information from servicemembers, their advocates and counselors, and industry participants, as well as hosting town hall meetings with military families and roundtable discussions with financial readiness program managers and counselors, legal assistance lawyers, chaplains, and other professionals serving the military community.

Similarly, the CFPB's Office of Older Americans will help seniors navigate their own unique financial challenges by helping to educate and clarify financial choices about long-term savings, retirement planning, and long-term care. The CFPB will also coordinate with senior groups, law enforcement, financial institutions, and other Federal and state agencies to identify and prevent scams targeting seniors.

Another accomplishment is the launch of the CFPB's Consumer Response Center, which began taking credit card complaints in July. On December 1, the CFPB started to take mortgage related complaints. In the coming months, the CFPB will take consumer complaints about other types of consumer financial products and services. The CFPB's August information sharing agreement with the Federal Trade Commission (FTC) allows it to access consumer complaints within the FTC's Consumer Sentinel system on a range of additional consumer financial products and services.

The Financial Stability Oversight Council

The Dodd-Frank Act created the Financial Stability Oversight Council to identify risks to the financial stability of the United States, promote market discipline, and respond to emerging threats to the stability of the U.S. financial system.

Prior to the Dodd-Frank Act's enactment, there was no effective forum for the senior leadership of Treasury, the Federal financial regulatory agencies and other experts to share information and engage as a group on a regular basis. In recent months, the Council's principals have come together to share information in response to possible risks to our financial system posed by credit ratings of U.S. debt, the failure of MF Global, and the ongoing sovereign debt crisis in Europe. Since I last testified in July, the Council has held six principals meetings, and in between these meetings the Council has had numerous conference calls to discuss market developments. Deputies meet at least every 2 weeks and staff of member agencies is in regular communication.

In July, the Council published its first annual report, which provided a comprehensive view of financial market developments and potential threats to our financial system. The report also includes recommendations to enhance the integrity, efficiency, competitiveness, and stability of the U.S. financial markets, promote market discipline, and maintain investor confidence.

Although independent agencies, not the Council itself, have the authority to address the annual report's recommendations regarding structural vulnerabilities, the Council continues to share information and review progress on each recommendation.

The Council has also made progress on two of its direct responsibilities under the Dodd-Frank Act: designating financial market utilities (FMUs) and nonbank financial companies for enhanced prudential standards and supervision.

In July, the Council finalized rules regarding the procedure for designating FMUs—firms that facilitate clearing and settlement in bond, currency, derivatives, and other financial markets—for enhanced risk management standards and supervision. The final rule benefited from public comments the Council solicited after it released an Advanced Notice of Proposed Rulemaking (ANPR) in November 2010 and a Notice of Proposed Rulemaking (NPR) in March 2011. The Council currently is analyzing firms for potential designation.

The Council is also making progress toward issuing a final rule that establishes quantitative and qualitative criteria and procedures for designations of nonbank financial companies. Prior to the financial crisis, these types of institutions operated largely beyond the boundaries of financial regulators' scope. This allowed them to take on excessive risks that threatened the stability of the financial system more broadly.

The Council received significant public input after publishing an ANPR in October 2010 and an NPR in January 2010. In October 2011, the Council published additional guidance, including specific metrics for potential designation and an analytical framework, for further public comment.

The Office of Financial Research

The Dodd-Frank Act established the Office of Financial Research to improve the quality of financial data available to policymakers and the public, and to facilitate more robust and sophisticated analysis of the financial system.

Richard Berner, as Counselor to the Treasury Secretary, has been leading our efforts to stand up the OFR while the Administration continues to evaluate candidates to serve as its Director.

The OFR has made progress hiring experts with deep experience in data management, technology, and risk management to support its work. Leading academics and quantitative finance experts are also lending their experience and knowledge to help establish the OFR's research operation, including its structure, agenda, and fellowship programs.

Treasury is committed to providing this implementation team with needed support and guidance, and I, along with other senior Treasury officials, meet with the team weekly to make sure the OFR's stand up is well-executed, priorities are identified, and progress is measured.

As the OFR continues to build its data infrastructure, it has also begun working on specific research projects to support the Council's monitoring of risks to the financial system. Just last week, the OFR and the Council hosted a conference that brought together thought leaders from the financial regulatory community, academia, public interest groups, and the financial services industry to discuss new technologies and analytical approaches for assessing, monitoring, and mitigating threats to financial stability. The OFR's research on financial stability and its projects to improve the quality of financial data were discussed at that conference.

Over the past year, the OFR's leadership has helped gain strong private sector support and international regulatory backing for the Legal Entity Identifier (LEI) initiative. This public-private initiative, which the OFR launched in November 2010, will create a global standard for the identification of parties to financial transactions. Such a standard will improve data quality and thus the abilities of regulators and firms to manage counterparty risk, assure the integrity of business practices, and lower processing costs for financial transactions.

Over the past few months, the LEI initiative has won a number of key endorsements, including from the G–20 and the Financial Stability Board (FSB), which both released public statements affirming their support for industry and financial regulators' efforts to establish an LEI.

To further progress on establishing an LEI globally, the OFR worked closely with the FSB and other international authorities to hold a workshop this past September to discuss how to coordinate on steps going forward. Representatives from international market participants and regulators voiced support for greater cooperation on the LEI initiative. Earlier this year, a global coalition of market participants and their members published recommendations for how to best adopt the LEI, and the International Organization for Standardization (ISO) developed a draft technical specification for the identifier.

The OFR has also begun working to facilitate interagency coordination on data collection efforts. The process leading to the adoption of Form PF shows the benefits that come from collaboration between the OFR and other members of the Financial Stability Oversight Council. The SEC and CFTC worked collaboratively with the Council and the OFR to harmonize Form PF and a related CFTC form to increase transparency for certain participants in the commodities market. Because of this alignment, the Council will be in a better position to aggregate the information gathered from private fund advisers and these commodity market participants for use in assessing systemic risk.

The OFR is working with regulators to catalogue the data they already collect to ensure the OFR relies on existing data whenever possible and to identify opportunities for efficiencies in contracting, collecting, processing, and distributing data. With this catalogue, the OFR will work with regulators to identify redundant data collection and reduce the reporting burden on financial institutions, while also strengthening and improving protections throughout the financial system.

Federal Insurance Office

The Dodd-Frank Act created the Federal Insurance Office to monitor all aspects of the insurance industry, identify issues or gaps in regulation that could contribute to a systemic crisis in the insurance industry or financial system, assess the accessibility and affordability of insurance products, coordinate and develop Federal policy on prudential aspects of international insurance matters, and contribute expertise to the Financial Stability Oversight Council.

In March, Treasury named Michael McRaith, former head of the Illinois Department of Insurance, as the FIO's Director and, in September, FIO announced 15 individuals drawn from industry, academia and consumer advocacy organizations to serve on the Federal Advisory Committee on Insurance, which advises FIO.

FIO is playing an increasingly important role both domestically and internationally as regulatory reform moves forward. In addition to advising the Council, FIO

is currently drafting a report on modernizing U.S. insurance regulation, on which it is currently seeking public comments. On December 9, FIO is hosting a conference to solicit additional public input. Among other subjects, panelists will focus on international regulatory developments, consumer protection, and solvency oversight.

In October, FIO became a full member of the International Association of Insurance Supervisors, which is currently working to designate globally significant insurers and develop a common framework for the supervision of internationally active insurance groups. FIO's membership in this group helps to ensure the U.S. position on insurance matters are represented with a single voice as regulators work on international insurance issues.

* * *

As the economy continues to recover from the worst financial crisis in generations, the Dodd-Frank Act will help protect Americans from the excess risk, fragmented oversight, and poor consumer protections that played such leading roles in bringing about the crisis. Our goal is a financial system that is not prone to panic and collapse; that helps Americans save for retirement and borrow to finance an education or a home without experiencing deception or abuse; and that helps businesses finance growth and investment and strengthen our economy.

We appreciate the leadership and support of this Committee throughout the reform process, and we look forward to working with Congress as we move forward toward this common goal.

Thank you.

PREPARED STATEMENT OF DANIEL K. TARULLO

MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DECEMBER 6, 2011

Chairman Johnson, Ranking Member Shelby, and other Members of the Committee, thank you for the opportunity to testify on the Federal Reserve's implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act).

The Federal Reserve's Approach to Dodd-Frank Implementation

Needless to say, implementation of the Dodd-Frank Act has been, and continues to be, a formidable task. At the Federal Reserve, hundreds of staff members are contributing to Dodd-Frank projects. We have issued 29 final rules, public notices, and reports already and we have another 13 rules underway. All told, we expect the Board will issue approximately 60 sets of rules and formal guidelines as part of its implementation efforts. We are working diligently to complete the remaining rules. The challenge arises from the sheer number of studies, rules, and other implementation tasks the Act requires the Federal Reserve to produce in a relatively short period of time. Moreover, much of the work involves the more time-consuming process of joint rulemakings or coordination with other agencies, all of which are facing similar demands.

For all the variation and complexity in our Dodd-Frank implementation responsibilities, we have several unifying goals.

First and foremost, we want to get it right. This means implementing the statute faithfully, in a manner that maximizes financial stability and other social benefits at the least cost to credit availability and economic growth. To achieve this balance, we have assembled interdisciplinary teams for our significant rulemakings, bringing together economists, supervisors, legal staff, and other specialists to help develop sensible policy alternatives and to help avoid unintended consequences.

Second, in addition to a thorough internal analytic process, we also are committed to soliciting and considering the comments of others. We are, of course, consulting extensively with other financial regulatory agencies, both bilaterally and through the Financial Stability Oversight Council. The interagency consultation process has included staff discussions during the initial policy development stage, sharing of draft studies and regulatory text in the interim phases, and dialogue among agency principals in the advanced stages of several rulemakings.

Along with the other agencies testifying today, we have gone well beyond the formal consultation requirements of Dodd-Frank. Members of the Board, as well as staff at senior levels, have regular meetings with their counterparts at other agencies to discuss implementation issues of common interest. Consultations at multiple levels and across agencies help to improve the consistency of regulation across the banking industry and reduce the potential for overlapping regulatory requirements. In addition, these consultations help highlight the interaction among different rules

under development by these agencies, as well as the interplay between proposed policy alternatives and existing regulations.

We are also trying to make our rulemaking process as fair and transparent as possible, with ample opportunity for the public to comment. During the proposal stage, we specifically seek comment from the public on the costs and benefits of our proposed approach, as well as on alternative approaches to our proposal. We believe strongly that public participation in the rulemaking process improves our ability to identify and resolve issues raised by our regulatory proposals. We generally provide the public a minimum of 60 days to comment on all significant rulemaking proposals, with longer periods permitted for especially complex or significant proposals.

Federal Reserve staff have participated in more than 300 meetings with outside parties and their representatives, including community and consumer groups. To promote transparency in the rulemaking process, we include in the public record a memorandum describing the attendees and subjects covered in any meetings involving nongovernmental participants at which Dodd-Frank rulemakings are discussed. These summaries are posted on the Federal Reserve Board's Web site on a weekly basis, as are updates on Board rulemakings and other Dodd-Frank initiatives.

Third, in drafting regulations, we have made special efforts to identify and, to the degree possible consistent with statutory requirements, minimize the regulatory burden on smaller entities. We conduct an assessment that takes appropriate account of the potential impact a rule may have on small businesses, small governmental jurisdictions, and small organizations affected by the rule, in accordance with the Regulatory Flexibility Act. We have paid particular attention to reducing the regulatory burden on community banking organizations. For example, the Federal Reserve has established community depository institution advisory councils at each of the 12 Federal Reserve banks. These councils gather input from community depository organizations on ways to reduce regulatory burden and improve the efficiency of our supervision, and also collect information about the economy from the perspective of community organizations throughout the Nation. A representative from each of these 12 advisory councils serves on a national Community Depository Institution Advisory Council that meets semiannually with the Board of Governors to bring together the ideas of all the advisory groups.

The Board of Governors has also established a subcommittee of our regulatory and supervisory oversight committee for the express purpose of reviewing all regulatory matters from the perspective of community depository organizations. These reviews are intended to find ways to reduce the burden on community depository organizations arising from our regulatory policies without reducing the effectiveness of those policies in improving the safety and soundness of depository organizations of all sizes.

Fourth, we are working to complete our Dodd-Frank projects as quickly as possible while meeting the three objectives already stated. There is obviously considerable value in providing as much clarity as possible as soon as possible to financial markets and the public about the post-crisis financial regulatory landscape.

Capital Regulation after Dodd-Frank

The breadth of Dodd-Frank's provisions reflects in part that the pre-crisis regulatory regime had been insufficiently attentive to a variety of risks from a variety of sources. But we should not forget that strong capital requirements remain the most supple form of prudential regulation, because they can provide a buffer against bank losses from any source. To put it simply, the best way to avoid another TARP is for our large regulated institutions to have adequate capital buffers, reflecting the damage that would be done to the financial system were such institutions to fail.

Implicitly, passage of Dodd-Frank was a criticism of the specific features of capital regulation that prevailed during the pre-crisis period. Basel I capital requirements relied almost exclusively on capital ratios that were snapshots of balance sheets and thus frequently a lagging indicator of a bank's condition. The kind of capital that qualified for regulatory purposes was not uniformly reliable as a buffer against losses. Moreover, capital requirements were set solely with reference to the balance sheet of each firm individually, with little attention to the economy-wide impact of financial stress at large institutions. And, most fundamentally, capital requirements had simply been too low, in general and with respect to the risk-weightings of certain assets.

Strong capital requirements must be at the center of the post-crisis period regulatory regime. The Federal Reserve is integrating the specific capital-related provisions of Dodd-Frank into its overall capital program. That program has three basic components: improving capital regulation at the level of individual firms; introducing a macroprudential or system-wide element to capital regulation; and con-

ducting regular stress testing and capital planning. I will discuss each of the three areas briefly.

The first component is to improve the traditional, firm-based approach to capital regulation. This work is mostly related to standards developed in cooperation with other supervisors in the Basel Committee on Banking Supervision, but there is also a Dodd-Frank element. The "Collins amendment" in Dodd-Frank provided a safeguard against declines in minimum capital requirements in a capital regime based on bank internal modeling. The so-called Basel 2.5 agreement strengthened the market risk capital requirements of Basel II. Basel III upgraded the quality of regulatory capital, increased the quantity of minimum capital requirements, created a capital conservation buffer, and introduced an international leverage ratio requirement. In the coming months the banking agencies will be jointly proposing regulations consistent with Basel 2.5 and Basel III.

The second component of our capital program is to introduce a macroprudential element to capital regulation. Section 165 of the Dodd-Frank Act mandated that the Board establish enhanced risk-based capital standards for large bank-holding companies. This mandate complements the Basel Committee's effort to develop a framework for assessing a capital surcharge on the largest, most interconnected banking organizations based on their global systemic importance. Both the Dodd-Frank provision and the Basel systemic surcharge framework are motivated by the fact that the failure of a systemically important firm would have dramatically greater negative consequences on the financial system and the economy than the failure of other firms. In addition, stricter capital requirements on systemically important firms should help offset any funding advantage these firms derive from their perceived status as too-big-to-fail and provide an incentive for such firms to reduce their systemic footprint.

Of course, Dodd-Frank requires the Federal Reserve to impose more stringent capital requirements on all bank-holding companies with assets of $50 billion or more, not just the U.S. firms that will appear on the Basel Committee's list of global systemic banks. No decision has yet been made as to whether the more stringent capital requirement to be applied to large U.S. banking firms that are not on the eventual list of global systemic banks will be in the form of a quantitative surcharge. However, analysis of the systemic footprints of these other U.S. bank-holding companies suggests that even if surcharges were to apply, their amounts would be quite modest, at least based on the current characteristics of these bank-holding companies.

The third component of the Federal Reserve's capital program is to establish regular, firm-specific stress testing and capital planning. Dodd-Frank creates two kinds of stress-testing requirements. First, it mandates that the Federal Reserve Board conduct annual stress tests on all bank-holding companies with $50 billion or more in assets to determine whether they have the capital needed to absorb losses in baseline, adverse, and severely adverse economic conditions. Second, it requires both these companies and certain other regulated financial firms with between $10 billion and $50 billion in assets to conduct internal stress tests.

We will be implementing the specific stress-testing requirements of Dodd-Frank beginning later in 2012. However, in the interim we are using a modified form of stress testing as part of the annual capital planning process we have established for large bank-holding companies. Last month we announced the parameters and process for this year's capital review, which will be completed in March, at which time the results of the stress test will be publicly reported for the 19 largest firms.

Conclusion

For all the work that has already gone into implementing Dodd-Frank, both at the Federal Reserve and at the other regulatory agencies, there is still considerable work to do. Final regulations implementing some of the Act's most important provisions, such as the "living will" requirement and the Collins amendment, are now in place. Measures to implement other prominent provisions, such as the Volcker rule, have been proposed, but are not yet in final form. Still others, such as the section 165 requirements, have not yet been proposed. Whether completing work on proposed regulations, or moving forward with those yet to be proposed, the Federal Reserve will continue to pursue the four goals I noted earlier.

Thank you very much for your attention. I would be pleased to answer any questions you might have for me.

Update on Key Implementation Initiatives of the Board of Governors of the Federal Reserve System Under the Dodd-Frank Wall Street Reform and Consumer Protection Act

The following highlights key initiatives undertaken by the Board of Governors of the Federal Reserve System (Board) in connection with the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act). As of December 5, 2011, the Board has issued seventeen final rules, three public notices and nine reports (Tables 1 and 2). The Board has proposed an additional thirteen rules for public comment.

Table 1. Summary of the Board's Rulemaking Efforts Under the Dodd-Frank Act as of December 5, 2011 [1]

Seq.	*Description*	*Due*	*Status*
Rulemaking Under Title I			
1.	**Final Rule to Establish Minimum Risk-Based Capital *Requirements* (Collins Amendment) [R-1402].** On June 14, 2011, the Board issued a joint final rule, along with the FDIC and the OCC, to establish a floor for the risk-based capital requirements applicable to the largest, internationally active banking organizations. (Section 171)	No Deadline	Completed.
2.	**Proposed Rule to Establish Certain Definitions Under Title I [R-1405].** On February 8, 2011, the Board issued a proposed rule to define when a nonbank company is "predominantly engaged" in financial activities; and the terms "significant nonbank financial company" and "significant bank holding company." (Section 102)	No Deadline	Comment period closed.
3.	**Final Rule on Resolution Plans (living wills) [R-1414].** On October 17, 2011, the Board and the FDIC issued a final rule that would require large, systemically significant bank holding companies and nonbank financial companies to submit annual resolution plans and quarterly credit exposure reports. (Section 165)	1/1/2012	Completed.

[1] The implementation initiatives highlighted below do not include the Board's rulemaking responsibilities as part of the Financial Stability Oversight Council, or rulemaking initiatives where the Board serves in a consultative role.

4.	**Final Rule on Capital Plans and Stress Testing Instructions [R-1425].** On November 22, 2011, the Board issued a final rule requiring top-tier U.S. bank holding companies (BHCs) with total consolidated assets of $50 billion or more to submit annual capital plans for review and provided stress testing instructions outlining the information to be provided for the Federal Reserve's 2012 Comprehensive Capital Analysis and Review. (Section 165(i)).	1/1/2012	Completed.
Rulemaking Under Title III			
5.	**Notice of Intent to Require Reporting Forms For Savings and Loan Holding Companies.** On February 3, 2011, the Board provided public notice of its intention to require savings and loan holding companies (SLHCs) to submit the same reports as bank holding companies, beginning with the March 31, 2012 reporting period. (Title III, generally)	No Deadline	Completed.
6.	**Notice Related to Supervision of SLHCs [OP-1416].** On April 15, 2011, the Board issued a public notice that outlines how it intends to apply certain parts of its current consolidated supervisory program for bank holding companies to SLHCs after assuming supervisory responsibility for SLHCs. (Title III, generally)	No Deadline	Comment period closed.
7.	**Notice of OTS Regulations To Be Continued.** On July 21, 2011, the Board issued a public notice of all OTS regulations that it anticipates continuing to enforce. (Section 316)	7/21/11	Completed.
8.	**Interim Final Rule to Amend OTS Regulations [R-1429].** On August 12, 2011, the Board issued an interim final rule setting forth regulations for SLHCs. The interim final rule has three components: (1) a new Regulation LL, setting forth regulations generally governing SLHCs; (2) a new Regulation MM, setting forth regulations governing SLHCs in mutual form (MHCs); and (3) several technical amendments to current Board regulations necessary to accommodate the transfer of supervisory authority for SLHCs from the OTS to the Board. (Section 312)	No Deadline	Completed.
9.	**Information Collection Proposal Related to the Supervision of SLHCs.** On August 22, 2011, the Board issued an information collection proposal for comment that would permit a two-year phase-in period for most SLHCs to file Federal Reserve regulatory reports with the Board and an exemption for some SLHCs from initially filing Federal Reserve regulatory reports. (Title III, generally)	No Deadline	Comment period closed.

Rulemaking Under Title VI			
10.	**Proposed Rule implementing the Volcker Rule Requirements.** On October 11, the Board requested public comment on a proposed rule that would implement Section 619 of the Act, which contains certain prohibitions and restrictions on the ability of a banking entity and nonbank financial company supervised by the Board to engage in proprietary trading and have certain interests in, or relationships with, a hedge fund or private equity fund. The comment period will be open until January 13, 2012. (Section 619, generally)	10/11/11	Comment period open.
11.	**Final Rule to Implement the Volcker Rule Conformance Period [R-1397].** On February 9, 2011, the Board issued a final rule to implement the provisions of the Act that give banking firms a period of time to conform their activities and investments to the prohibitions and restrictions of the Volcker Rule. (Section 619(c)(6))	1/21/11	Completed.
12.	**Final Rule to Allow Interest on Demand Deposits [R-1413].** On July 14, 2011, the Board issued a final rule repealing Regulation Q and allowing payment of interest on demand deposits at institutions that are member banks of the Federal Reserve System. (Section 627)	No Deadline	Completed.
13.	**Proposed Rule on Registration of Securities Holding Companies [R-1430].** On August 31, 2011, the Board issued a proposed rule that outlines the requirements that a nonbank company that owns at least one registered broker or dealer, and that is required by a foreign regulator or provision of foreign law to be subject to comprehensive consolidated supervision (securities holding company), must satisfy in order to register with the Board and subject themselves to supervision by the Board. (Section 618)	No Deadline	Comment period closed.
Rulemaking Under Title VII			
14.	**Proposed Rule on Margin and Capital Requirements for Swaps [R-1415].** On April 12, 2011, the Board issued a joint proposed rule with the FCA, FDIC, FHFA and OCC to establish margin and capital requirements for swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants. The Agencies previously extended the comment period to July 11, 2011, to allow interested persons more time to analyze the issues and prepare their comments. (Sections 731 and 764)	No Deadline	Comment period closed.

15.	**Proposed Rule on Retail Foreign Exchange Futures and Options [R-1428].** On July 28, 2011, the Board issued a proposed rule that that sets standards for banking organizations regulated by the Federal Reserve who engage in certain types of foreign exchange transactions with retail customers. (Section 742)	No Deadline	Comment period closed.
Rulemaking Under Title VIII			
16.	**Proposed Rule on Financial Market Utilities (FMU) Risk Management Standards and Procedures [R-1412].** On March 30, 2011, the Board issued a proposed rule related to the supervision of FMUs designated as systemically important by the Financial Stability Oversight Council. (Sections 801and 806)	No Deadline	Comment period closed.
Rulemaking Under Title IX			
17.	**Advanced Notice of Proposed Rulemaking on Alternatives to the Use of Credit Ratings in Capital Rules (Regulations H and Y) [R-1391].** On August 10, 2010, the Board issued an advanced notice of proposed rulemaking regarding the alternatives to the use of credit ratings in the risk-based capital rules for banking organizations. (Section 939A)	No Deadline	Comment period closed.
18.	**Proposed Rule on Credit Risk Retention [R-1411].** On March 29, 2011, the Board issued a joint proposed rule with five other federal agencies, to implement the credit risk retention requirements applicable in connection with the issuance of asset-backed securities. The agencies previously had extended the comment period for the proposed rule to allow interested persons more time to analyze the issues and prepare their comments. (Section 941)	4/17/11	Comment period closed.
19.	**Proposed Rule on Incentive Compensation [R-1410].** On March 30, 2011, the Board issued a joint proposed rule with the OCC, FDIC, OTS, NCUA, SEC and FHFA to prohibit incentive-based compensation arrangements that encourage inappropriate risk-taking by covered financial companies, and to require the disclosure and reporting of certain incentive-based compensation information by covered financial companies. (Section 956)	4/21/11	Comment period closed.

Rulemaking Under Title X			
20.	**Final Rule on Data Requirements for Motor Vehicle Dealers [R-1426].** On September 20, 2011, the Board issued a final rule under Regulation B to clarify that motor vehicle dealers are not required to comply with certain data collection requirements in Act until the Board issues final regulations to implement the statutory requirements. (Section 1071)	No Deadline	Completed.
21.	**Proposed Rules on Remittance Transfers Disclosures (Regulation E) [R-1419].** On May 12, 2011, the Board issued a proposed rule to require that remittance transfer providers make certain disclosures to senders of remittance transfers, including information about fees and the exchange rate, as applicable, and the amount of currency to be received by the recipient. The proposed rule also would provide error resolution and cancellation rights for senders of remittance transfers. (Section 1073)	1/21/12	Comment period closed (rule has been transfer to the CFPB).
22.	**Debit Interchange—Final Rules Establishing Interchange Standards and Limitations on Payment Card Restrictions [R-1404].** On June 29, 2011, the Board issued a final rule to establish standards for debit card interchange fees, regulations governing network fees, and prohibitions against network exclusivity arrangements and routing restrictions. The statutory deadline for issuing interchange and network fee rules was April 21, 2011. The final rules to implement the exclusivity and routing restrictions of the Act were not due until July 21, 2011, but have been combined with the rules on interchange fees. (Section 1075)	4/21/11 and 7/21/11	Completed.
23.	**Debit Interchange—Interim Final Rule Regarding Fraud Prevention Adjustment [R-1404].** On June 29, 2011, the Board issued an interim final rule that allows for an upward adjustment of no more than 1 cent to an issuer's debit card interchange fee if the issuer develops and implements policies and procedures reasonably designed to achieve the rule's fraud-prevention standards. (Section 1075)	4/21/11	Completed.

Rulemaking Under Title XI			
24.	**Final Rule to Expand Coverage Under the Truth in Lending Act (Regulation Z) [R-1399].** On March 25, 2011, the Board issued a final rule to require creditors to disclose key terms of consumer loans and prohibit creditors from engaging in certain practices with respect to those loans. (Section 1100(E))	No Deadline	Completed.
25.	**Final Rule to Expand Coverage Under the Consumer Leasing Act (Regulation M) [R-1400].** On March 25, 2011, the Board issued a final rule requiring lessors to provide consumers with disclosures regarding the cost and other terms of personal property leases. (Section 1100(E))	No Deadline	Completed.
26.	**Final Rule to Increase Exemption Threshold Under the Consumer Leasing Act (Regulation M) [R-1423].** On March 25, 2011, the Board issued a final rule under Regulation M (Consumer Leasing) to increase the dollar threshold for exempt consumer lease transactions. These annual adjustments are required by statute. (Section 1100(E))	No Deadline	Completed.
27.	**Final Rule to Increase Exemption Threshold Under the Truth in Lending Act (Regulation Z) [R-1424].** On March 25, 2011, the Board issued a final rule to increase the dollar threshold for exempt consumer credit transactions. These annual adjustments are required by statute. (Section 1100(E))	No Deadline	Completed.
28.	**Final Rule Revising Risk-Based Pricing Notices Under the Fair Credit Reporting Act (FCRA) (Regulation V) [R-1407].** On July 6, 2011, the Board and the FTC issued a joint final rule to revise the content requirements for risk-based pricing notices and to add related model forms to reflect the new credit score disclosure requirements. (Section 1100F)	No Deadline	Completed.
29.	**Final Rule Implementing Combined FCRA Notices Under the Equal Credit Opportunity Act (Regulation B) [R-1408].** On July 6, 2011, the Board issued a final rule amending Regulation B to include the disclosure of credit scores and related information if a credit score is used in taking adverse action. The revised model notices reflect the new content requirements in section 615(a) of the FCRA, as amended by section 1100F of the Act. (Section 1100F)	No Deadline	Completed.

Rulemaking Under Title XIV			
30.	**Proposed Rule on Escrow Account Requirements Under the Truth in Lending Act (Regulation Z) [R-1406].** On February 23, 2011, the Board issued a proposed rule to expand the minimum period for mandatory escrow accounts for first-lien, higher-priced mortgage loans from one to five years, and longer under certain circumstances; provide an exemption from the escrow requirement for certain creditors that operate in rural or underserved counties; and implement new disclosure requirements contained in the Act. (Sections 1411, 1412 and 1414)	1/21/13	Comment period closed (rule has been transfer to the CFPB)
31.	**Proposed Rule Regarding Ability to Repay Under the Truth In Lending (Regulation Z) [R-1417].** On April 19, 2011, the Board issued a proposed rule under Regulation Z that would require creditors to determine a consumer's ability to repay a mortgage before making the loan and would establish minimum mortgage underwriting standards. The proposal would also implement the Act's limits on prepayment penalties. The Board is soliciting comment on the proposed rule until July 22, 2011. (Sections 1411, 1412 and 1414)	1/21/13	Comment period open (rule has been transfer to the CFPB)
32.	**Final Rule on Escrow Requirements Under the Truth in Lending Act (Regulation Z) [R-1392].** On February 23, 2011, the Board issued a final rule to increase the annual percentage rate threshold used to determine whether a mortgage lender is required to establish an escrow account for property taxes and insurance for first-lien "jumbo" residential mortgage loans, effective April 1, 2011. (Section 1461)	1/21/13	Completed.
33.	**Interim Final Rule on Appraisal Independence (Regulation Z) [R-1394].** On October 18, 2010, the Board issued an interim final rule that is intended to ensure that real estate appraisers are free to use their independent professional judgment in assigning home values without influence or pressure from those with interests in the transactions. (Section 1472)	10/19/10	Completed.

Table 2. Reports and Studies Under the Dodd-Frank Act

Seq.	*Description*	*Due*	*Status*
1.	**Study of the Impact of Credit Risk in Securitization Markets.** On October 19, 2010, the Board issued a report on the potential impact of credit risk retention requirements on securitization markets. (Section 941)	10/19/10	Completed.
2.	**Report on OTS Transition Plan.** On January 25, 2011, the Board, OTS, OCC, and FDIC issued a joint report to Congress and the Inspectors General of the participating agencies on the agencies' plans to implement the transfer of OTS authorities. (Section 327)	1/20/11	Completed.
3.	**Report on Debit Card Transactions.** On June 29, 2011, the Board issued a report disclosing certain aggregate or summary information concerning interchange transaction and payment card network fees charged or received in connection with electronic debit transactions. (Section 1075)	7/21/11	Completed.
4.	**Study of the Resolution of Financial Companies under the Bankruptcy Code.** The Board has approved a study, which the Board has conducted, in consultation with the Administrative Office of the U.S. Courts, related to the resolution of financial companies under the Bankruptcy Code. (Section 216)	7/21/11	Completed.
5.	**Study of International Coordination Relating to the Resolution of Systemic Financial Companies.** The Board has approved a study, which the Board has conducted, in consultation with the Administrative Office of the U.S. Courts, regarding international coordination relating to the resolution of systemic financial companies under the Bankruptcy Code and applicable foreign law. (Section 217)	7/21/11	Completed.
6.	**Report on Remittance Transfers: Automated Clearing House Expansion (ACH).** On July 19, 2011, the Board approved a report to Congress on the status of ACH expansion for remittance transfers to foreign countries. (Section 1073)	7/21/11	Completed.

7.	**Report on Designated Clearing Entities.** The Board, CFTC and SEC have approved and soon will issue a joint report to Congress containing recommendations for promoting robust risk management standards and consistency in the supervisory programs of the CFTC and SEC for designated clearing entities. (Section 813)	7/21/11	Completed.
8.	**Report on the Use of Credit Ratings in the Board's Rules.** The on July 25, 2011, the Board issued a report to Congress discussing the review the Board has conducted on the use of credit ratings in its regulations and sometime thereafter report to Congress. (Section 939A)	7/21/11	Completed.
9.	**Report on Government Prepaid Cards.** On July 21, the Board issued a report to Congress on the use of prepaid cards by government authorities, and the interchange transaction and cardholder fees charged with respect to such prepaid cards. (Section 1075)	7/21/11	Completed.

Table 3. Other Implementation Initiatives Under the Dodd-Frank Act

Seq.	*Description*	*Due*	*Status*
1.	**Assistance to the Financial Stability Oversight Council (FSOC).** The Board has been providing significant support to the FSOC. The Board continues to assist the FSOC in designing its systemic risk monitoring and evaluation process and in developing its analytical framework and procedures for identifying systemically important nonbank firms and FMUs. The Board also has contributed significantly to the FSOC's recent studies and reports. (Title I, generally)	Various deadlines	Ongoing.
2.	**OTS Transition Initiatives.** The Board has made substantial progress in its plans relating to the transfer of the supervisory authority of the OTS for SLHCs to the Board. (Title III, generally)	Transfer date was 7//21/11	Ongoing.
3.	**Establishment of the Consumer Financial Protection Bureau (CFPB).** The Board has established a transition team, headed by Governor Duke, to work closely with staff at the CFPB and at the Treasury Department to facilitate the transition. (Title X, generally)	Transfer date was 7/21/11	Ongoing.

4.	**Federal Reserve Governance, Transparency and Audit Initiatives.** On December 1, 2010, the Board provided detailed information on its public website about more than 21,000 individual credit and other transactions conducted during the financial crisis. The Board also has provided on its public website certain audit and related financial information, including audit reports, financial statements and reports to Congress on the Board's facilities under Section 13(3) of the Federal Reserve Act. (Sections 1109 and 1103)	12/1/10 for certain disclosures	Ongoing.
5.	**Office of Minority and Women Inclusion.** The Board and the Federal Reserve Banks each have established a formal Office of Minority and Women Inclusion to consolidate and build on existing equal opportunity and contracting resources. (Section 342)	1/21/11	Ongoing.

PREPARED STATEMENT OF MARY L. SCHAPIRO

CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

DECEMBER 6, 2011

Chairman Johnson, Ranking Member Shelby, and Members of the Committee:

Thank you for inviting me to testify regarding the Securities and Exchange Commission's ongoing implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or "Act").[1]

The Dodd-Frank Act makes significant changes in the regulatory landscape for the SEC. Among other things, the Act brings hedge fund and other private fund advisers under the regulatory umbrella of the Investment Advisers Act of 1940 ("Advisers Act"), creates a new whistleblower program, establishes an entirely new regime for the over-the-counter ("OTC") derivatives market, enhances the SEC's authority over nationally recognized statistical rating organizations ("NRSROs") and clearing agencies, and heightens regulation of asset-backed securities ("ABS").

To implement the Act, the SEC was tasked with writing a large number of new rules and conducting over 20 studies and reports. Over the past 16 months, we have made great progress toward completing those tasks. Of the more than 90 provisions in the Act that require SEC rulemaking, the SEC already has proposed or adopted rules for over three-fourths of those that are required. Additionally, the SEC has finalized 12 of the more than 20 studies and reports that the Act directs us to complete. While we have had much success, we continue our work to implement all provisions of the Act for which we have responsibility—even as we also perform our longstanding core responsibilities of pursuing securities violations, reviewing public company disclosures and financial statements, inspecting the activities of investment advisers, investment companies, broker-dealers and other registered entities, and maintaining fair and efficient markets.

In my prior opportunities to testify before this Committee about Dodd-Frank Act implementation, I outlined our efforts to modernize our internal processes to enable us to better accomplish both our preexisting responsibilities and those added by the Act. Among others, these efforts include the creation of new cross-disciplinary working groups; our focus on increasing transparency, consultation and public input; and the forging and strengthening collaborative relationships with other Federal regulators and our international counterparts. To date, we have participated in scores of interagency and working group meetings, conducted seven public roundtables, met with hundreds of interested groups and individuals including investors, academics and industry participants, and received, reviewed and considered thousands of public comments.

The considerable progress we have made so far is the result of the exceptional work of my fellow Commissioners and our staff, whose extraordinary efforts have enabled us to accomplish so much in a relatively short time. While the Dodd-Frank Act added significantly to their workload, they have been implementing the Act in a thoughtful, thorough, and professional manner.

My testimony today will provide an overview of these activities, emphasizing the Commission's efforts since I last testified before this Committee on Dodd-Frank Act implementation in July.

Hedge Fund and Other Private Fund Adviser Registration and Reporting

The Dodd-Frank Act mandated that the Commission require private fund advisers (including hedge and private equity fund advisers) to confidentially report information about the private funds they manage for the purpose of the assessment of systemic risk by the Financial Stability Oversight Council ("FSOC"). On October 31, 2011, in a joint release with the CFTC, based on staff consultation with staff representing members of FSOC, the Commission adopted a new rule that requires hedge fund advisers and other private fund advisers registered with the Commission to report systemic risk information on a new form ("Form PF").[2] Under the new rule, Commission registered investment advisers managing at least $150 million in private fund assets will periodically file Form PF. The data collection will dovetail with the enhanced private fund reporting discussed below.

The Form PF reporting requirements are scaled to the adviser. Advisers with less than a certain amount of hedge fund, liquidity fund or private equity fund assets

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[1] The views expressed in this testimony are those of the Chairman of the Securities and Exchange Commission and do not necessarily represent the views of the full Commission.

[2] *See* Release No. IA–3308, *Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF* (October 31, 2011), *http://www.sec.gov/rules/final/2011/ia-3308.pdf.*

under management will report only very basic information on an annual basis. Advisers with assets under management over specified thresholds will report more information, and large hedge fund and liquidity fund advisers also will report on a quarterly basis. This approach is intended to provide FSOC with a broad picture of the industry while relieving smaller advisers from much of the reporting requirements. In addition, the reporting requirements are tailored to the types of funds that an adviser manages and the potential risks those funds may present, meaning that an adviser will respond only to questions that are relevant to its business model. The Dodd-Frank Act provides special confidentiality protections for this data. The initial stages of this reporting will begin next year.

In addition to this important reporting rule, the Commission already has completed many of the rulemakings required by the Dodd-Frank Act amendments to the Advisers Act.

- In June, the Commission adopted rules that: require the registration of, and reporting by, advisers to hedge funds and other private funds and other advisers previously exempt from SEC registration; require reporting by investment advisers relying on certain new exemptions from SEC registration; and reallocate regulatory responsibility to the state securities authorities for advisers that have between $25M and $100M in assets under management.[3]
- Concurrently, the Commission adopted rules to implement new adviser registration exemptions created by the Dodd-Frank Act. The new rules implement new exemptions for: (i) advisers solely to venture capital funds; (ii) advisers solely to private funds with less than $150 million in assets under management in the United States; and (iii) certain foreign advisers without a place of business in the United States and with only a *de minimis* amount of U.S. business.[4]
- The Commission also adopted a new rule defining "family offices"—a group that historically has not been required to register as advisers—that will be excluded from the definition of an investment adviser under the Advisers Act.[5]
- In May, the Commission proposed changes to the rule that permits investment advisers to charge certain clients performance fees.[6] The rule's conditions already include minimum standards, such as net worth, that clients must satisfy for the adviser to charge these fees. The proposed amendments would incorporate the revised dollar amount levels that the Commission adjusted by order this past July to account for the effects of inflation, as required by the Dodd-Frank Act. The amendments also would remove the value of a client's primary residence from the calculation of net worth.

Staff Studies Regarding Investment Advisers and Broker-Dealers

In January 2011, the Commission submitted to Congress two staff studies in the investment management area as required under the Dodd-Frank Act.

The first study, mandated by Section 914, analyzed the need for enhanced examination and enforcement resources for investment advisers that are registered with the Commission.[7] It found that the Commission likely will not have sufficient capacity in the near or long term to conduct effective examinations of registered investment advisers with adequate frequency. Therefore, the study stated that the Commission's examination program requires a source of funding that is adequate to permit the Commission to meet new examination challenges and sufficiently stable to prevent adviser examination resources from continuously being outstripped by growth in the number of registered investment advisers.

The study highlighted the following three options to strengthen the Commission's investment adviser examination program: (1) imposing user fees on Commission-registered investment advisers to fund their examinations; (2) authorizing one or more self-regulatory organizations that assess fees on their members to examine, subject

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[3] *See* Release No. IA–3221, *Rules Implementing Amendments to the Investment Advisers Act* (June 22, 2011), *http://www.sec.gov/rules/final/2011/IA-3221.pdf.*

[4] *See* Release No. IA–3222 *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers* (June 22, 2011), *http://www.sec.gov/rules/final/2011/IA-3222.pdf.*

[5] *See* Release No. IA–3220, Family Offices (June 22, 2011), *http://www.sec.gov/rules/final/ia-3220.pdf.*

[6] *See* Release No. IA–3198, *Investment Adviser Performance Compensation* (May 10, 2011), *http://www.sec.gov/rules/proposed/2011/ia-3198.pdf.*

[7] *See Study on Enhancing Investor Adviser Examinations* (January 2011), *http://www.sec.gov/news/studies/2011/914studyfinal.pdf; see also* Commissioner Elisse B. Walter, Statement on Study Enhancing Investment Adviser Examinations (Required by Section 914 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act) (Jan. 2010), *http://www.sec.gov/news/speech/2011/spch011911ebw.pdf.*

to Commission oversight, all Commission-registered investment advisers; or (3) authorizing FINRA to examine a subset of advisers—*i.e.,* dually registered investment advisers and broker-dealers—for compliance with the Advisers Act.

The second staff study, required by Section 913 of the Dodd-Frank Act (the "IA/BD Study"), addressed the obligations of investment advisers and broker-dealers.[8] This study reviewed the broker-dealer and investment adviser industries, the regulatory landscape surrounding each, issues raised by stakeholders who commented during the preparation of the report, and other considerations.

The IA/BD Study made two primary recommendations: that the Commission (1) exercise its discretionary rulemaking authority to implement a uniform fiduciary standard of conduct for broker-dealers and investment advisers when they are providing personalized investment advice about securities to retail investors; and (2) consider harmonization of broker-dealer and investment adviser regulation when broker-dealers and investment advisers provide the same or substantially similar services to retail investors and when such harmonization adds meaningfully to investor protection.

Under Section 913, the uniform fiduciary standard to which broker-dealers and investment advisers would be subject would be "no less stringent" than the standard that applies to investment advisers today.

As the IA/BD Study notes, the distinction between an investment adviser and a broker-dealer is often lost on investors, and it remains difficult to justify why there should be different rules and standards of conduct for the two roles—especially when the same or substantially similar services are being provided. Investment professionals' first duty must be to their clients, and we are giving serious consideration to the study's recommendations.

The staff is currently considering the contours of rulemaking following on the study, including the costs and benefits of options for rulemaking. The staff also is continuing to meet with academics, and industry and investor representatives who have an interest in or insights into the results and recommendations of the study. In addition, the Commission's economists are considering available data that would help inform any potential rule recommendation.

Whistleblower Program

Section 922 of the Dodd-Frank Act established a whistleblower program that requires the SEC to pay an award to eligible whistleblowers who voluntarily provide the agency with original information about a violation of the Federal securities laws that leads to a successful SEC enforcement action. The Act also required the Commission to promulgate rules to implement the program.

Our final rules, adopted in May, became effective on August 12, 2011. Since then, the Commission has received hundreds of tips through the whistleblower program from individuals all over the country and in many parts of the world. That, of course, is in addition to the tens of thousands of tips, complaints, and referrals the agency receives every year. Our new Office of the Whistleblower is reviewing these submissions and working with whistleblowers. The office recently filed its Annual Report to Congress detailing its many activities since its creation. These include, among other things, the establishment of an outreach program, internal training programs, development of policies and procedures, meeting with whistleblowers and their counsel, and coordination on investigations with Commission staff.

We already are reaping the early benefits of the whistleblower program through active and promising investigations utilizing crucial whistleblower information, some of which we hope may lead to rewards in the near future. In addition, the quality of the information we are receiving has, in many instances, enabled our investigative staff to work more efficiently, thereby allowing us to better utilize our resources.

Additional Investor Protection Provisions

The Commission continues to exercise its expanded enforcement authority by utilizing many of the other investor protection provisions contained in the Dodd-Frank Act. For example, we use our new "collateral bar" authority to bar or suspend persons who have engaged in serious misconduct in one segment of the financial services industry that the Commission regulates from other segments that the Commission also regulates.

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[8] *See Study on Investment Advisers and Broker-Dealers* (January 2011), *http://www.sec.gov/news/studies/2011/913studyfinal.pdf; see also* Statement by SEC Commissioners Kathleen L. Casey and Troy A. Paredes Regarding Study on Investment Advisers and Broker-Dealers (January 21, 2011), *http://www.sec.gov/news/speech/2011/spch012211klctap.htm.*

In addition, the Commission has used its authority granted in Section 929P(a) to impose penalties in administrative cease and desist actions against nonregulated individuals and entities. Although the Commission could impose penalties against regulated persons administratively prior to Dodd-Frank, it could obtain penalties against nonregulated persons only in enforcement actions filed in district court. The Act now permits the Commission to obtain penalties against nonregulated violators of the Federal securities laws in either forum. In one recent example of our exercise of this authority, the Commission imposed a $3 million administrative penalty against an alcoholic beverage producer for violations of the Foreign Corrupt Practices Act involving more than $2.7 million in illicit payments to government officials in India, Thailand and South Korea.[9] Prior to the Dodd-Frank Act, the Commission would not have been able to impose a penalty against the company in a cease-and-desist proceeding; that sanction would only have been available in a district court action. Accordingly, to obtain full relief, the Commission would have had to either file the entire action in district court or, alternatively, file two separate actions—one administrative and one civil. With the new authority granted in Section 929P(a), the Commission no longer has to file multiple actions or abandon what may be the more appropriate forum in order to obtain an appropriate penalty.

Section 929E of the Dodd-Frank Act allowed for nationwide service of process so that the SEC could compel a witness to appear at trial anywhere in the United States. This new tool has enhanced our enforcement efforts by providing our trial attorneys with greater access to key witnesses and documents at trial.

These are just a few examples of the many ways in which we are utilizing our expanded authority to more effectively protect investors. And, these new tools are augmenting our Enforcement Division's own, proactive initiatives to enhance its effectiveness by bringing more cases—and more significant cases—more swiftly and more efficiently. Indeed, in recently ended fiscal year 2011, the SEC filed 735 enforcement actions—more enforcement actions than ever filed in a single year in SEC history. As a result of our aggressive enforcement activity, we obtained more than $2.8 billion in penalties and disgorgement ordered in fiscal year 2011.

OTC Derivatives

Among the key provisions of the Dodd-Frank Act are those that will establish a new oversight regime for the OTC derivatives marketplace. Title VII of the Dodd-Frank Act requires the Commission to work with other regulators—the CFTC in particular—to write rules that:

- Address, among other things, mandatory clearing, the operation of trade execution facilities and data repositories, business conduct standards for certain market intermediaries, capital and margin requirements, and public transparency for transactional information;
- Improve transparency and facilitate the centralized clearing of swaps, helping, among other things, to reduce counterparty risk and systemic risk that results from exposures by market participants to uncleared swaps;
- Enhance investor protection by increasing security-based swap transaction disclosure and helping to mitigate security-based swap conflicts of interest; and
- Allow the OTC derivatives market to continue to develop in a more transparent, efficient, and competitive manner.

Title VII Implementation to Date

To date, the Commission has proposed rules in 13 areas required by Title VII:

- Rules prohibiting fraud and manipulation in connection with security-based swaps;[10]
- Rules regarding trade reporting, data elements, and real-time public dissemination of trade information for security-based swaps that would lay out who must report security-based swaps, what information must be reported, and where and when it must be reported;[11]

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[9] *See In the Matter of Diageo Plc, Release No. 34–64978* (July 27, 2011) *http://www.sec.gov/litigation/admin/2011/34-64978.pdf*

[10] *See* Release No. 34–63236, *Prohibition Against Fraud, Manipulation, and Deception in Connection with Security-Based Swaps* (November 3, 2010), *http://www.sec.gov/rules/proposed/2010/34-63236.pdf.*

[11] *See* Release No. 34–63346, *Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information* (November 19, 2010), *http://www.sec.gov/rules/proposed/2010/34-63346.pdf.*

- Rules regarding the obligations of security-based swap data repositories that would require them to register with the Commission and specify the extensive confidentiality and other requirements with which they must comply;[12]
- Joint rules with the CFTC regarding the definitions of swap and security-based swap dealers, and major swap and security-based swap participants;[13]
- Rules relating to mandatory clearing of security-based swaps that would establish a process for clearing agencies to provide information to the Commission about security-based swaps that the clearing agencies plan to accept for clearing;[14]
- Rules regarding the exception to the mandatory clearing requirement for hedging by end users that would specify the steps that end users must follow, as required under the Dodd-Frank Act, to notify the Commission of how they generally meet their financial obligations when engaging in security-based swap transactions exempt from the mandatory clearing requirement;[15]
- Rules regarding the confirmation of security-based swap transactions that would govern the way in which certain of these transactions are acknowledged and verified by the parties who enter into them;[16]
- Rules defining and regulating security-based swap execution facilities, which specify their registration requirements, and establish the duties and implement the core principles for security-based swap execution facilities specified in the Dodd-Frank Act;[17]
- Rules regarding certain standards that clearing agencies would be required to maintain with respect to, among other things, their risk management and operations;[18]
- Joint rules with the CFTC regarding further definitions of the terms "swap," "security-based swap," and "security-based swap agreement;" the regulation of mixed swaps; and security-based swap agreement recordkeeping;[19]
- Rules regarding business conduct that would establish certain minimum standards of conduct for security-based swap dealers and major security-based swap participants, including in connection with their dealings with "special entities," which include municipalities, pension plans, endowments and similar entities;[20]
- Rules regarding the registration process for security-based swap dealers and major security-based swap participants;[21] and
- Rules intended to address conflicts of interest at security-based swap clearing agencies, security-based swap execution facilities, and exchanges that trade security-based swaps.[22]

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[12] *See* Release No. 34–63347, *Security-Based Swap Data Repository Registration, Duties, and Core Principles* (November 19, 2010), *http://www.sec.gov/rules/proposed/2010/34-63347.pdf.*

[13] *See* Release No. 34–63452, *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap participant" and "Eligible Contract Participant"* (December 7, 2010), *http://www.sec.gov/rules/proposed/2010/34-63452.pdf.*

[14] *See* Release No. 63557, *Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b–4 and Form 19b–4 Applicable to All Self-Regulatory Organizations* (December 15, 2010), *http://www.sec.gov/rules/proposed/2010/34-63557.pdf.*

[15] *See* Release No. 34–63556, *End-User Exception of Mandatory Clearing of Security-Based Swaps* (December 15, 2010), *http://www.sec.gov/rules/proposed/2010/34-63556.pdf.*

[16] *See* Release No. 34–63727, *Trade Acknowledgment and Verification on Security-Based Swap Transactions* (January 14, 2011), *http://www.sec.gov/rules/proposed/2011/34-63727.pdf.*

[17] *See* Release No. 34–63825, *Registration and Regulation of Security-Based Swap Execution Facilities* (February 2, 2011), *http://www.sec.gov/rules/proposed/2011/34-63825.pdf.*

[18] *See* Release No. 34–64017, *Clearing Agency Standards for Operation and Governance* (March 2, 2011), *http://www.sec.gov/rules/proposed/2011/34-64017.pdf.*

[19] *See* Release No. 33–9204, *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping* (April 27, 2011), *http://www.sec.gov/rules/proposed/2011/33-9204.pdf.*

[20] *See* Release No. 34–64766, *Business Conduct Standards for Security-Based Swaps Dealer and Major Security-Based Swap Participants* (June 29, 2011), *http://www.sec.gov/rules/proposed/2011/34-64766.pdf.*

[21] *See* Release No. 34–65543, *Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants* (October 12, 2011), *http://www.sec.gov/rules/proposed/2011/34-65543.pdf.*

[22] *See* Release No. 34–63107, *Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC* (October 14, 2010), *http://www.sec.gov/rules/proposed/2010/34-63107.pdf.*

The Commission adopted an interim final rule regarding the reporting of outstanding security-based swaps entered into prior to the date of enactment of the Dodd-Frank Act.[23] This interim final rule notifies certain security-based swap dealers and other parties of the need to preserve and report to the Commission or a registered security-based swap data repository certain information pertaining to any security-based swap that was entered into prior to the July 21, 2010 passage of the Dodd-Frank Act and whose terms had not expired as of that date.

In addition, to facilitate clearing of security-based swaps, the Commission has proposed rules providing exemptions under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Trust Indenture Act of 1939 for security-based swaps transactions involving certain clearing agencies satisfying certain conditions.[24] We also readopted certain of our beneficial ownership rules to preserve their application to persons who purchase or sell security-based swaps.[25]

Moreover, the Commission has taken a number of steps to provide legal certainty and avoid unnecessary market disruption that might otherwise have arisen as a result of final rules not having been enacted by the July 16 effective date of Title VII. Specifically, we have:

- Provided guidance regarding which provisions in Title VII governing security-based swaps became operable as of the effective date and provided temporary relief from several of these provisions;[26]
- Provided guidance regarding—and where appropriate, interim exemptions from—the various pre-Dodd-Frank provisions that would otherwise have applied to security-based swaps on July 16;[27] and
- Taken other actions to address the effective date, including extending certain existing temporary rules and relief to continue to facilitate the clearing of certain credit default swaps by clearing agencies functioning as central counterparties.[28]

Next Steps for Implementation of Title VII

While the Commission has made significant progress to date, much remains to be done to fully implement Title VII. First, we need to complete the core elements of our proposal phase, in particular, rules related to the financial responsibility of security-based swap dealers and major security-based swap participants.

In addition, because the OTC derivatives market has grown to become a truly global market in the last three decades, we must continue to evaluate carefully the international implications of Title VII. Rather than deal with these implications piecemeal, we intend to address the relevant international issues holistically in a single proposal. The publication of such a proposal would give investors, market participants, foreign regulators, and other interested parties an opportunity to consider as an integrated whole our proposed approach to the registration and regulation of foreign entities engaged in cross-border transactions involving U.S. parties.

After proposing all of the key rules under Title VII, we intend to seek public comment on an implementation plan that will facilitate a roll-out of the new securities-based swap requirements in a logical, progressive, and efficient manner that minimizes unnecessary disruption and costs to the markets. Many market participants have advocated that the Commission adopt a phased-in approach, whereby compli-

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[23] *See* Release No. 34–63094, *Reporting of Security-Based Swap Transaction Data* (October 13, 2010), *http://www.sec.gov/rules/interim/2011/34-63094.pdf.*

[24] *See* Release No. 33–9222, *Exemptions for Security-Based Swaps Issued by Certain Clearing Agencies* (June 9, 2011), *http://www.sec.gov/rules/proposed/2011/33-9222.pdf.*

[25] *See* Release No. 34–64628, *Beneficial Ownership Reporting Requirements and Security-Based Swaps* (June 8, 2011), *http://www.sec.gov/rules/final/2011/34-64628.pdf.*

[26] *See* Release No. 34–64678, *Temporary Exemptions and Other Temporary Relief, Together with Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps* (June 15, 2011), *http://www.sec.gov/rules/exorders/2011/34-64678.pdf.*

[27] *See* Release No. 34–64795, *Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of "Security" to Encompass Security-Based Swaps, and Request for Comment* (July 1, 2011), *http://sec.gov/rules/exorders/2011/34-64795.pdf;* and Release No. 33–9231, Exemptions for Security-Based Swaps (July 1, 2011), *http://www.sec.gov/rules/interim/2011/33-9231.pdf.*

[28] *See* Release No. 34–64796, *Order Pursuant to Section 36 of the Securities Exchange Act of 1934 Granting Temporary Exemptions from Clearing Agency Registration Requirements under Section 17A(b) of the Exchange Act for Entities Providing Certain Clearing Services for Security-Based Swaps* (July 1, 2011), *http://sec.gov/rules/exorders/2011/34-64796.pdf;* and Release No. 33–9232 *Extension of Temporary Exemptions for Eligible Credit Default Swaps to Facilitate Operation of Central Counterparties to Clear and Settle Credit Default Swaps* (July 1, 2011), *http://www.sec.gov/rules/interim/2011/33-9232.pdf.*

ance with Title VII's requirements would be sequenced. Commission staff is actively engaged in developing an implementation proposal that takes into consideration market participants' recommendations with regard to such sequencing.

Clearing Agencies

Title VIII of the Dodd-Frank Act provides for increased regulation of financial market utilities and financial institutions that engage in payment, clearing and settlement activities that are designated as systemically important. Clearing agencies play a critical role in the financial markets by ensuring that transactions settle on time and on agreed-upon terms. The purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability.

To promote the integrity of clearing agency operations and governance, the Commission proposed certain enhanced requirements for clearing agencies.[29] Specifically, the proposed rules would require clearing agencies to maintain certain standards with respect to risk management and operations, have adequate safeguards and procedures to protect the confidentiality of trading information, have procedures that identify and address conflicts of interest, require minimum governance standards for boards of directors, designate a chief compliance officer, and disseminate pricing and valuation information if the clearing agency performs central counterparty services for security-based swaps. Many of the proposed requirements would apply to all clearing agencies, while others would focus more specifically on clearing agencies that clear security-based swaps.

The proposal was the result of close work between the Commission staff and staffs of the CFTC and the Federal Reserve Board ("Board"). The proposed requirements are consistent with—and build on—current international standards, and they are designed to further strengthen the Commission's oversight of securities clearing agencies, promote consistency in the regulation of clearing organizations generally, and thereby help to ensure that clearing agency regulation reduces systemic risk in the financial markets. The comment period for the proposal ended on April 29, 2011 and we received approximately 25 comments. We expect to consider final rules and revisions in light of comments received in the near future.[30]

In addition, as directed by Title VIII, the SEC staff worked jointly with the staffs of the CFTC and the Board over the past year to develop a report to Congress reflecting recommendations regarding risk management supervision of clearing entities designated as systemically important by the FSOC—each called a "designated clearing entity" or "DCE". The staffs of the agencies met regularly and engaged in constructive dialogue to develop a framework for improving consistency in the DCE oversight programs of the SEC and CFTC, promoting robust risk management by DCEs, promoting robust risk management oversight by DCE regulators, and improving regulators' ability to monitor the potential effects of DCE risk management on the stability of the financial system of the United States. The joint report was submitted to Congress in July and recommended finalizing rulemakings to establish enhanced risk management for DCEs, formalizing the process for consultations and information sharing regarding DCEs, enhancing DCE examinations, and developing ongoing consultative mechanisms to promote understanding of systemic risk. The report should establish a strong framework for ongoing consultation and cooperation in clearing agency oversight among the Commission, the CFTC, and the Board, which in turn should help to mitigate systemic risk and promote financial stability.

Credit Rating Agencies

Under the Dodd-Frank Act, the Commission is required to undertake approximately a dozen rulemakings related to nationally recognized statistical rating organizations ("NRSROs"). The Commission adopted the first of these required rulemakings in January 2011,[31] and in May, the Commission published for public comment a series of proposed rules that would further implement this requirement.[32] The proposed rules are intended to strengthen the integrity of credit ratings

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[29] *See* Release No. 34–64017, *Clearing Agency Standards for Operation and Governance* (March 3, 2011), *http://www.sec.gov/rules/proposed/2011/34-64017.pdf.*

[30] The CFTC adopted final rules regarding standards for derivatives clearing organizations based on the applicable core principles on October 18, 2011. *See Derivatives Clearing Organization General Provisions and Core Principles,* 76 FR 69334 (November 8, 2011), *http://www.cftc.gov/ucm/groups/public/@lrFederalregister/documents/file/2011-27536a.pdf.*

[31] *See* Release No. 33–9175, *Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (January 20, 2011), *http://www.sec.gov/rules/final/2011/33-9175.pdf.*

[32] *See* Release No. 34–64514, Proposed Rules for Nationally Recognized Statistical Rating Organizations (May 18, 2011), *http://www.sec.gov/rules/proposed/2011/34-64514.pdf.*

by, among other things, improving their transparency. Under the Commission's proposals, NRSROs would, among other things, be required to:

- Report on their internal controls;
- Better protect against conflicts of interest;
- Establish professional standards for their credit analysts;
- Publicly provide—along with the publication of any credit rating—disclosure about the credit rating and the methodology used to determine it; and
- Provide enhanced public disclosures about the performance of their credit ratings.

In addition, the proposals would require disclosure concerning third-party due diligence reports for asset-backed securities.

The Dodd-Frank Act requires the SEC to conduct three studies relating to credit rating agencies. In December 2010, the Commission requested public comment on the feasibility and desirability of standardizing credit rating terminology.[33] The Commission received 16 comment letters in response to this request, and Commission staff has reviewed the comments received and is working toward producing a final product. The Dodd-Frank Act also requires (1) a study, due in July 2012, about alternative compensation models for rating structured finance products and (2) a study, due in 2013, about NRSRO independence.

With respect to alternative compensation models, the Dodd-Frank Act directs the Commission to study the credit rating process for structured finance products and the conflicts associated with the "issuer-pay" and the "subscriber-pay" models. The Commission also must study the feasibility of establishing a system in which a public or private utility or a self-regulatory organization would assign NRSROs to determine the credit ratings for structured finance products. Accordingly, in May 2011 the Commission published a request for public comment on the feasibility of such a system, asking interested parties to provide comments, proposals, data and analysis.[34] The comment period ended on September 13, 2011. The Commission received 29 comment letters in response to its request for comments, which Commission staff is currently reviewing.

The Dodd-Frank Act also requires every Federal agency to review its regulations that require use of credit ratings as an assessment of the credit-worthiness of a security and undertake rulemakings to remove these references and replace them with other standards of credit worthiness that the agency determines are appropriate. The Commission has taken the following steps to fulfill this requirement:

- In July 2011, the Commission adopted rule amendments removing credit ratings as conditions for companies seeking to use short-form registration when registering nonconvertible securities for public sale. Under the new rules, the test for eligibility to use Form S–3 or Form F–3 short-form registration is tied to the amount of debt and other nonconvertible securities (other than equity) a particular company has sold in registered primary offerings within the previous 3 years, or that the company has outstanding that were issued in registered primary offerings.[35] In addition, prior to adoption of the Act, in April 2010 the Commission proposed new requirements to replace the current credit rating references in shelf eligibility criteria for asset-backed security issuers with new shelf eligibility criteria.[36]
- In April 2011, the Commission proposed to remove references to credit ratings in rules concerning broker-dealer financial responsibility, distributions of securities, and confirmations of transactions.[37]

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[33] *See* Release No. 34–63573, *Credit Rating Standardization Study* (December 17, 2010), *http://sec.gov/rules/other/2010/34-63573.pdf.*

[34] *See* Release No. 34–64456, *Solicitation of Comment to Assist in Study on Assigned Credit Ratings* (May 10, 2011), *http://www.sec.gov/rules/other/2011/34-64456.pdf.*

[35] *See* Release No. 33–9245, *Security Ratings* (July 27, 2011), *http://www.sec.gov/rules/final/2011/33-9245.pdf.*

[36] *See* Release No. 33–9117, *Asset-Backed Securities* (April 7, 2010), *http://www.sec.gov/rules/proposed/2010/33-9117.pdf.*

[37] *See* Release No. 34–64352, *Removal of Certain References to Credit Ratings under the Securities Exchange Act of 1934* (April 27, 2011), *http://www.sec.gov/rules/proposed/2011/34-64352.pdf.*

- In March 2011, the Commission proposed to remove credit ratings from rules relating to the types of securities in which a money market fund can invest.[38] This proposal includes amendments to Rule 2a–7, which governs the operation of money market funds and requires these funds to invest only in highly liquid, short-term investments of the highest quality. These proposed amendments would replace the current requirement that rated portfolio securities have received a first or second tier rating. They are designed to offer protections comparable to those provided by NRSRO ratings and to retain a degree of risk limitation similar to the current rule.

In September 2010, the Commission also adopted a rule amendment to remove communications with credit rating agencies from the list of excepted communications in Regulation FD, as required by Section 939B of the Dodd-Frank Act.[39]

Finally, the Dodd-Frank Act requires the SEC to conduct staff examinations of each NRSRO at least annually and to issue an annual report summarizing the exam findings. Our staff recently successfully completed the first cycle of these exams, and the Commission approved the publication of the staff's summary report of the examinations.[40] The staff will continue to focus on completing the statutorily mandated annual examinations of each NRSRO, including follow-up from prior examinations, and making public the summary report of those examinations.

Volcker Rule

In October 2011, the Commission proposed a rule jointly with the Federal banking agencies to implement Section 619 of the Dodd-Frank Act, commonly referred to as the "Volcker Rule."[41] This proposal reflects an extensive, collaborative effort by the Federal banking agencies, the SEC, the CFTC, and their respective staffs to design a rule to implement the Volcker Rule's prohibitions and restrictions in a manner that is consistent with the language and purpose of this complex statute. In developing this proposal, interagency staffs gave close and thoughtful consideration to the FSOC's January 2011 study and its recommendations for implementing Section 619.[42] As a result, the joint proposal builds upon many of the recommendations set forth in the FSOC study, including the use of quantitative measurements to distinguish prohibited proprietary trading from permitted market-making-related activity and the requirement that banking entities develop robust programmatic compliance regimes.

As required by the statute, the joint proposal generally prohibits banking entities from engaging in proprietary trading and having certain interests in, and relationships with, hedge funds and private equity funds. The proposed rule also provides certain exceptions to these general prohibitions, consistent with the statute. For example, the proposal permits a banking entity to engage in underwriting, market-making-related activity, risk-mitigating hedging, and organizing and offering a private equity fund or hedge fund, among other permitted activities, provided that specific requirements set forth in the proposed rule are met. Further, as established by Section 619, an otherwise-permitted activity would be prohibited under the proposed rule if it involved a material conflict of interest, high-risk assets or trading strategies, or a threat to the safety and soundness of the banking entity or to the financial stability of the United States. The proposal defines "material conflict of interest," "high-risk asset," and "high-risk trading strategy" for these purposes. As set forth in the Dodd-Frank Act, the Commission's rule would apply to banking entities for which the Commission is the primary financial regulatory agency. These banking entities include, among others, certain registered broker-dealers, investment advisers, and security-based swap dealers.

The joint proposal requests comment on a wide range of issues due, in part, to the complexity of the issues presented by the statute and the proposal. The comment period for this proposal ends on January 13, 2012. We look forward to receiv-

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[38] *See* Release Nos. 33–9193; IC–29592, *References to Credit Ratings in Certain Investment Company Act Rules and Forms* (March 3, 2011), *http://www.sec.gov/rules/proposed/2011/33-9193.pdf.*

[39] *See* Release No. 33–9146, *Removal from Regulation FD of the Exemption for Credit Rating Agencies* (September 29, 2010), *http://www.sec.gov/rules/final/2010/33-9146.pdf.*

[40] *See 2011 Summary Report of Commission Staff's Examinations of Each Nationally Recognized Statistical Rating Organization* (September 2011), *http://www.sec.gov/news/studies/2011/2011_nrsro_section15e_examinations_summary_report.pdf.*

[41] *See* Release No. 34–65545, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds* (October 12, 2011), *http://www.sec.gov/rules/proposed/2011/34-965545.pdf.*

[42] The FSOC Volcker Rule study and recommendations can be found at *http://www.treasury.gov/initiatives/Documents/Volcker%20sec%20%20619%20study%20final%2018%2011%20rg.pdf.*

ing and considering public comment on this proposal and continuing to work with the other regulators to further refine the rule prior to adoption.

Municipal Advisors

Section 975 of the Dodd-Frank Act creates a new class of regulated persons, "municipal advisors," and requires these advisors to register with the Commission. This new registration requirement, which became effective on October 1, 2010, makes it unlawful for any municipal advisor, among other things, to provide advice to a municipal entity unless the advisor is registered with the Commission. In September 2010, the Commission adopted an interim final rule establishing a temporary means for municipal advisors to satisfy the registration requirement.[43] In December 2010, the Commission proposed a permanent rule that would create a new process by which municipal advisors must register with the SEC.[44] We have received over 1,000 comment letters on the proposal, including many that express concerns regarding the treatment of appointed officials and traditional banking products and services. We are giving these comments careful consideration before adopting a final rule. In addition, we are continuing to discuss many interpretive issues with other regulators and interested market participants so that the final rule will strike an appropriate balance by ensuring that parties engaging in municipal advisory activities are appropriately registered, without unnecessarily imposing additional regulation.

Asset-Backed Securities

The Commission has been active in implementing Subtitle D of Title IX of the Dodd-Frank Act, entitled "Improvements to the Asset-Backed Securitization Process." In August 2011, the Commission adopted rules in connection with Section 942(a) of the Dodd-Frank Act, which eliminated the automatic suspension of the duty to file reports under Section 15(d) of the 1934 Act for ABS issuers and granted the Commission authority to issue rules providing for the suspension or termination of this duty to file reports. The new rules permit suspension of the reporting obligations for ABS issuers when there are no longer asset-backed securities of the class sold in a registered transaction held by non-affiliates of the depositor.[45]

On March 30, 2011, the Commission joined its fellow regulators in issuing for public comment proposed risk retention rules to implement Section 941 of the Act.[46] Section 941, which is codified as new Section 15G of the Securities Exchange Act of 1934, generally requires the Commission, the Board, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and, in the case of the securitization of any "residential mortgage asset," the Federal Housing Finance Agency and Department of Housing and Urban Development, to jointly prescribe regulations that require a securitizer to retain not less than 5 percent of the credit risk of any asset that the securitizer—through the issuance of an asset-backed security—transfers, sells, or conveys to a third party. Section 15G also provides that the jointly prescribed regulations must prohibit a securitizer from directly or indirectly hedging or otherwise transferring the credit risk that the securitizer is required to retain.[47]

Under the proposed rules, a sponsor generally would be permitted to choose from a menu of four risk retention options to satisfy its minimum 5 percent risk retention requirement. These options were designed to provide sponsors with flexibility while also ensuring that they actually retain credit risk to align incentives. The proposed rules also include three transaction-specific options related to securitizations involving revolving asset master trusts, asset-backed commercial paper conduits, and commercial mortgage-backed securities. Also, as required by Section 941, the proposal provides a complete exemption from the risk retention requirements for ABS collateralized solely by "qualified residential mortgages" (or QRMs) and establishes the terms and conditions under which a residential mortgage would qualify as a QRM. We have received a number of comments regarding the QRM exemption, which we will carefully consider as we move forward with the interagency rulemaking process. Although the original comment period was scheduled to close on

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[43] *See* Release No. 34–62824, *Temporary Registration of Municipal Advisors* (September 1, 2010), *http://www.sec.gov/rules/interim/2010/34-62824.pdf.*

[44] *See* Release No. 34–63576, Registration of Municipal Advisors (December 20, 2010), *http://sec.gov/rules/proposed/2010/34-63576.pdf.*

[45] *See* Release No. 34–65148, *Suspension of the Duty to File Reports for Classes of Asset-Backed Securities under Section 15(d) of the Securities Exchange Act of 1934* (August 17, 2011), *http://www.sec.gov/rules/final/2011/34-65148.pdf.*

[46] *See* Release No. 34–64148, *Credit Risk Retention* (March 30, 2011), *http://www.sec.gov/rules/proposed/2011/34-64148.pdf.*

[47] *See* § 78o–11(c)(1)(A).

June 10, 2011, in light of requests from various sources for an extension to allow sufficient time for data gathering and impact analyses related to the provisions of the proposed rule, we extended the comment period to August 1, 2011.

The Commission also adopted rules in January 2011 implementing Section 943, on the use of representations and warranties in the market for ABS,[48] and Section 945, which requires an asset-backed issuer in a Securities Act registered transaction to perform a review of the assets underlying the ABS and disclose the nature of such review.[49]

We also are working on rules requiring the disclosure of asset-level information regarding the assets backing each tranche or class of security.[50]

Prohibition against Conflicts of Interest in Certain Securitizations

In September 2011, the Commission proposed a rule to implement the prohibition under Section 621 of the Dodd-Frank Act, which prohibits entities that create and distribute asset-backed securities from engaging in transactions that involve or result in material conflicts of interest with respect to the investors in such asset-backed securities.[51] The proposed rule would implement this provision by prohibiting underwriters, placement agents, initial purchasers, sponsors of an asset-backed security, or any affiliate or subsidiary of such entity from engaging in any transaction that would involve or result in any material conflicts of interest with respect to any investor in the relevant asset-backed security. These entities, referred to as "securitization participants," assemble, package and distribute asset-backed securities, and so may benefit from the activity that Section 621 is designed to prohibit. The prohibition would apply to both nonsynthetic and synthetic asset-backed securities and would apply to both registered and unregistered offerings of asset-backed securities.

Under the proposal, a conflict of interest would arise if a securitization participant would benefit directly or indirectly from either the actual, anticipated, or potential (a) adverse performance of the asset pool supporting or referenced by the relevant asset-backed security, (b) loss of principal, monetary default or early amortization event on the asset-backed security, ***or*** (c) decline in the market value of the asset-backed security; or as a result of allowing a third party, directly or indirectly, to structure the relevant asset-backed security or select assets underlying the asset-backed security in a way that facilitates or creates an opportunity for that third party to benefit from a short transaction. The conflict would be material if there is a substantial likelihood that a reasonable investor would consider the conflict important to his or her investment decision.

The proposed rule contains three exceptions mandated by the statute for bona fide market-making, liquidity commitments and risk-mitigating hedging activities. In developing the proposal, we considered comments received in response to the Commission's general solicitation of comments on the implementation of the Dodd-Frank Act. Commenters suggested that applying the statutory prohibition in a broad manner might impair the asset-backed securities market. The proposal is not intended to prohibit legitimate securitization activities, but rather, to prohibit the type of conduct at which Section 621 is aimed. We asked many questions in the release to ensure that we strike the right balance of prohibiting the type of conduct at which the statute is targeted without restricting other securitization activities.

The Commission looks forward to public comment regarding this proposal, including comment on the potential interplay between this proposal and Section 619 of the Dodd-Frank Act. The 90-day comment period for this rule ends on December 19, 2011.

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[48] *See* Release No. 33–9175, *Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (January 20, 2011), *http://www.sec.gov/rules/final/2011/33-9175.pdf.*

[49] *See* Release No. 33–9176, *Issuer Review of Assets in Offerings of Asset-Backed Securities* (January 20, 2011), *http://www.sec.gov/rules/final/2011/33-9176.pdf.*

[50] *See* Section 942(b) of the Dodd-Frank Act. In April 2010, the Commission proposed, among other things, to require that, with some exceptions, prospectuses for public offerings of ABS and ongoing Exchange Act reports contain specified asset-level information about each of the assets in the pool. *See* Release No. 33–9117, *Asset-Backed Securities* (April 7, 2010), *http://www.sec.gov/rules/proposed/2010/33-9117.pdf.* In July 2011, the Commission requested additional comment on the 2010 proposals relating to asset-level data in light of Section 942(b) and comments received on the 2010 proposals. *See* Release No. 33–9244, *Re-proposal of Shelf Eligibility Conditions for Asset-Backed Securities and Other Additional Requests for Comment* (July 26, 2011), *http://www.sec.gov/rules/proposed/2011/33-9244.pdf.* The proposals, if adopted, would implement the requirements for registered offerings of Section 942(b).

[51] *See* Release No. 34–65355, *Prohibition against Conflicts of Interest in Certain Securitizations* (September 19, 2011), *http://www.sec.gov/rules/proposed/2011/34-65355.pdf.*

Corporate Governance and Executive Compensation

The Dodd-Frank Act includes an array of corporate governance and executive compensation provisions that require Commission rulemaking. Among others, such rulemakings include:

- **Say on Pay.** The Commission adopted rules in January 2011 that require, in accordance with Section 951 of the Act, public companies subject to the Federal proxy rules to provide a shareholder advisory "say-on-pay" vote on executive compensation, a separate shareholder advisory vote on the frequency of the say-on-pay vote, and disclosure about, and a shareholder advisory vote to approve, compensation related to merger or similar transactions, known as "golden parachute" arrangements.[52] The Commission also proposed rules to implement the Section 951 requirement that institutional investment managers report their votes on these matters at least annually.[53]
- **Compensation Committee and Adviser Requirements.** Section 952 requires the Commission to, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any equity security of an issuer that does not comply with new compensation committee and compensation adviser requirements. In March 2011, the Commission issued a proposal to implement Section 952 that would require the exchanges to establish listing standards that require each member of a listed issuer's compensation committee to be a member of the board of directors and to be "independent."[54]

  The proposed rules also would direct the exchanges to prohibit the listing of any equity security of any issuer that is not in compliance with certain requirements relating to compensation committees and compensation advisers. The proposal also would amend the Commission's existing compensation consultant disclosure rules to require disclosure about whether the issuer's compensation committee retained or obtained the advice of a compensation consultant; whether the work of the compensation consultant has raised any conflicts of interest; and, if so, the nature of any such conflict and how it is being addressed. The comment period for the proposal ended on May 19, 2011, and the staff is currently developing recommendations for final rules.
- **Incentive-Based Compensation Arrangements.** Section 956 of the Dodd-Frank Act requires the Commission along with six other financial regulators to jointly adopt regulations or guidelines governing the incentive-based compensation arrangements of certain financial institutions, including broker-dealers and investment advisers with $1 billion or more of assets. Working with the other regulators, in March the Commission published for public comment a proposed rule that would address such arrangements. The Commission has received voluminous comment letters on the proposed rule, and the Commission staff, together with staff from the other regulators, is carefully considering the issues and concerns raised in those comments before adopting final rules.
- **Prohibition on Broker Voting of Uninstructed Shares.** Section 957 of the Act requires the rules of each national securities exchange to be amended to prohibit brokers from voting uninstructed shares on the election of directors (other than uncontested elections of directors of registered investment companies), executive compensation matters, or any other significant matter, as determined by the Commission by rule. To date, the Commission has approved changes to the rules with regard to director elections and executive compensation matters for most of the national securities exchanges,[55] and we anticipate

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[52] *See* Release No. 33–9178, *Shareholder Approval of Executive Compensation and Golden Parachute Compensation* (January 25, 2011), *http://www.sec.gov/rules/final/2011/33-9178.pdf.*

[53] *See* Release No. 34–63123, *Reporting of Proxy Votes on Executive Compensation and Other Matters* (October 18, 2010), *http://www.sec.gov/rules/proposed/2010/34-63123.pdf.*

[54] *See* Release No. 33–9199, *Listing Standards for Compensation Committees* (March 30, 2011), *http://www.sec.gov/rules/proposed/2011/33-9199.pdf.*

[55] *See* Release No. 34–62874 (September 9, 2010), *http://www.sec.gov/rules/sro/nyse/2010/34-62874.pdf* (New York Stock Exchange); Release No. 34–62992 (September 24, 2010), *http://www.sec.gov/rules/sro/nasdaq/2010/34-62992.pdf* (NASDAQ Stock Market LLC); Release No. 34–63139 (October 20, 2010), *http://www.sec.gov/rules/sro/ise/2010/34-63139.pdf* (International Securities Exchange); Release No. 34–63917 (February 16, 2011), *http://www.sec.gov/rules/sro/cboe/2011/34-63917.pdf* (Chicago Board Options Exchange); Release No. 34–63918 (February 16, 2011), *http://www.sec.gov/rules/sro/c2/2011/34-63918.pdf* (C2 Options Exchange, Incorporated); Release No. 34–64023 (March 3, 2011), *http://www.sec.gov/rules/sro/bx/2011/34-64023.pdf* (NASDAQ OMX BX, Inc.); Release No. 34–64121 (March 24, 2011), *http://www.sec.gov/rules/sro/chx/2011/34-64121.pdf* (Chicago Stock Exchange); Release No. 34–64122 (March 24, 2011), *http://www.sec.gov/rules/sro/phlx/2011/34-64122.pdf* (NASDAQ

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that corresponding changes to the rules of the remaining national securities exchanges will be considered by the Commission in the near future.

The Commission also is required by the Act to adopt several additional rules related to corporate governance and executive compensation, including rules mandating new listing standards relating to specified "clawback" policies,[56] and new disclosure requirements about executive compensation and company performance,[57] executive pay ratios,[58] and employee and director hedging.[59] These provisions of the Act do not contain rulemaking deadlines, but the staff is working on developing recommendations for the Commission concerning the implementation of these provisions of the Act.

Specialized Disclosure Provisions

Title XV of the Act contains specialized disclosure provisions related to conflict minerals, coal or other mine safety, and payments by resource extraction issuers to foreign or U.S. Government entities. The Commission published rule proposals for the three specialized disclosure requirements in December 2010, and the comment period ended on March 2, 2011.[60] In October, the Commission hosted a public roundtable to discuss key issues related to the conflict mineral rulemaking, including what is covered by the rule, what steps will be required to comply with the rule, and reporting under the rule. In connection with the roundtable, the Commission reopened the comment period until November 1, 2011 to allow comments to be submitted on the matters discussed at the roundtable. On all three of these rulemakings, the staff is developing recommendations for the Commission's consideration.

Exempt Offerings

Under Section 926 of the Act, the Commission is required to adopt rules that disqualify securities offerings involving certain "felons and other 'bad actors'" from relying on the safe harbor from Securities Act registration provided by Rule 506 of Regulation D. The Commission proposed rules to implement the requirements of Section 926 on May 25, 2011.[61] Under the proposal, the disqualifying events include certain criminal convictions, court injunctions and restraining orders; certain final orders of state securities, insurance, banking, savings association or credit union regulators, Federal banking agencies or the National Credit Union Administration; certain types of Commission disciplinary orders; suspension or expulsion from membership in, or from association with a member of, a securities self-regulatory organization; and certain other securities-law related sanctions. The comment period for this rule proposal ended on July 14, 2011 and the staff is currently developing recommendations for final rules.

In addition, the Commission proposed rule amendments in January that would implement Section 413(a) of the Act, which requires the Commission to exclude the value of an individual's primary residence when determining if that individual's net worth exceeds the $1 million threshold required for "accredited investor" status.[62] The comment period on this proposal ended on March 11, 2011 and the staff is preparing final rule recommendations for the Commission. This section was effective on the date of enactment of the Dodd-Frank Act; the implementing rules are designed to clarify the requirements and codify them in the Commission's rules.

Financial Stability Oversight Council

In addition to the rulemaking activity described above, Title I of the Dodd-Frank Act created the FSOC, and with it, a formal structure for coordination among the

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OMX PHLX LLC); Release No. 34–64186 (April 5, 2011), *http://www.sec.gov/rules/sro/edgx/2011/34-64186.pdf* (EDGX Exchange); Release No. 34–64187 (April 5, 2011), *http://www.sec.gov/rules/sro/edga/2011/34-64187.pdf* (EDGA Exchange); Release No. 34–65804 (November 22, 2011), *http://www.sec.gov/rules/sro/nsx/2011/34-65804.pdf* (National Stock Exchange, Inc.).

[56] *See* Section 954 of the Dodd-Frank Act.

[57] *See* Section 953(a) of the Dodd-Frank Act.

[58] *See* Section 953(b) of the Dodd-Frank Act.

[59] *See* Section 955 of the Dodd-Frank Act.

[60] *See* Release No. 34–63547, *Conflict Minerals* (December 15, 2010), *http://www.sec.gov/rules/proposed/2010/34-63547.pdf;* Release No. 33–9164, Mine Safety Disclosure (December 15, 2010), *http://www.sec.gov/rules/proposed/2010/33-9164.pdf,* Release No. 34–63549, Disclosure of Payments by Resource Extraction Issuers (December 15, 2010), *http://www.sec.gov/rules/proposed/2010/34-63549.pdf.*

[61] *See* Release No. 33–9211, *Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings* (May 25, 2011), *http://www.sec.gov/rules/proposed/2011/33-9211.pdf.*

[62] *See* Release No. 33–9177, *Net Worth Standard for Accredited Investors* (January 25, 2011), *http://www.sec.gov/rules/proposed/2011/33-9177.pdf.*

various financial regulators to monitor systemic risk and to promote financial stability across our Nation's financial system. FSOC has the following primary responsibilities:

- Identifying risks to the financial stability of the United States that could arise from the material financial distress or failure—or ongoing activities—of large, interconnected bank-holding companies or nonbank financial holding companies, or that could arise outside the financial services marketplace;
- Promoting market discipline by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the Government will shield them from losses in the event of failure (*i.e.,* addressing the moral hazard problem of "too big to fail"); and
- Identifying and responding to emerging threats to the stability of the United States financial system.[63]

As Chairman of the SEC, I am a voting member of FSOC. Senior SEC staff and I have actively participated in the FSOC and found its focus on identifying and addressing risks to the financial system to be important and helpful to the SEC as a capital markets regulator. The FSOC also has fostered a healthy and positive sense of collaboration among the financial regulators, facilitating cooperation and coordination for the benefit of investors and our overall financial system. Since passage of the Dodd-Frank Act, the FSOC has taken steps to create an organizational structure, coordinate interagency efforts, and build the foundation for meeting its statutory responsibilities.

For example, SEC staff worked with staff at other FSOC agencies on the October release of FSOC's second notice of proposed rulemaking regarding systemically important nonbank financial institutions ("nonbank SIFIs"). This release proposes the processes and considerations by which FSOC will designate nonbank SIFIs for heightened supervision by the Board. As proposed, nonbank financial companies will generally be assessed in a three-stage process:

- Stage 1: FSOC will apply uniform quantitative thresholds using publicly available data to identify those nonbank financial companies that will be subject to further evaluation.
- Stage 2: FSOC will further analyze the nonbank financial companies identified in Stage 1 using a broader range of information available primarily through existing public and regulatory sources.
- Stage 3: FSOC will contact each nonbank financial company that FSOC believes merits further review to collect information directly from the company that was not available in the earlier stages. At the end of Stage 3, based on the results of the analyses conducted during each stage of review, FSOC may vote to make a determination regarding the company.

Financial Market Utilities ("FMUs") are essential to the proper functioning of the Nation's financial markets.[64] These utilities form critical links among marketplaces and intermediaries that can strengthen the financial system by reducing counterparty credit risk among market participants, creating significant efficiencies in trading activities, and promoting transparency in financial markets. However, FMUs by their nature create and concentrate new risks that could affect the stability of the broader financial system. To address these risks, Title VIII of the Dodd-Frank Act provides important new enhancements to the regulation and supervision of FMUs designated as systemically important by FSOC ("DFMUs") and of payment, clearance and settlement activities. This enhanced authority in Title VIII should provide consistency, promote robust risk management and safety and soundness, reduce systemic risks, and support the stability of the broader financial system.[65] Importantly, the enhanced authority in Title VIII is designed to be in addition to the authority and requirements of the Securities Exchange Act and Commodity Exchange Act that may apply to FMUs and financial institutions that conduct designated activities.[66]

FSOC established an interagency DFMU committee to develop a framework for the designation of systemically important FMUs, in which staff from the SEC has actively participated. The FSOC finalized the rule establishing a designation process

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[63] *See* Dodd-Frank Act § 112(a)(1).

[64] Section 803(6) of the Dodd-Frank Act defines a financial market utility as "any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person."

[65] *See* Dodd-Frank Act § 802.

[66] *See* Dodd-Frank Act § 805.

for FMUs in July,[67] after first publishing an advanced notice of proposed rulemaking seeking public comment on the designation process generally, and a notice of proposed rulemaking seeking public comment on the specific process it proposed to follow when reviewing the systemic importance of FMUs.

New Commission Offices

In addition to the Whistleblower Office mentioned above, the Dodd-Frank Act requires the Commission to create four new offices within the Commission, specifically, the Office of Credit Ratings, Office of the Investor Advocate, Office of Minority and Women Inclusion, and Office of Municipal Securities. As each of these offices is statutorily required to report directly to the Chairman, the creation of these offices has been subject to approval by the Commission's Appropriations subcommittees.

As discussed below, both Congressional Appropriations committees approved creation of the Office of Minority and Women Inclusion in FY 2011 in July and we created that office soon thereafter.

As for the remaining three offices, the SEC's pending FY 2012 request, if approved, would allow the agency to establish the offices at levels adequate to enable those offices to execute their new responsibilities. In the meantime, the initial functions of these offices are being performed on a limited basis by other divisions and offices.

Office of Minority and Women Inclusion

Section 342 of the Act requires that we establish an Office of Minority and Women Inclusion. In mid-July 2011, the House and Senate Appropriations Committees approved the SEC's reprogramming request to create such an office. Shortly after, the SEC established its Office of Minority and Women Inclusion (OMWI). OMWI is currently staffed by two full-time employees and an Acting Director. A nationwide search for a permanent Director of the Office is underway and our hope is to be able to announce a selection by the end of the year. Although OMWI is a separate unit from the agency's EEO Office, due to budgetary restrictions, resource challenges, and the fact that the EEO Director has been designated as OMWI Acting Director, OMWI is presently housed in our EEO Office space. A benefit from this arrangement is that OMWI is able to leverage EEO Office resources to implement its requirements under Section 342.

OMWI has been collaborating with a number of SEC divisions and offices to meet the requirements of Section 342, including, but not limited to, the Office of the Chairman, Division of Enforcement, Division of Corporation Finance, Office of Investor Education and Advocacy, Office of Human Resources, Office of Acquisitions, Office of Financial Management, Office of General Counsel, and Office of Information Technology. This collaboration ranges from providing guidance and input on the standards to be developed under Section 342, to supporting OMWI's infrastructural needs (data systems and data feeds), to actual participation in a number of diversity and pipeline development initiatives.

OMWI continues to make strides to enhance the inclusion of minorities and women in the workforce and business activities of the agency. Since OMWI's establishment, the SEC has sponsored or participated in approximately 20 events to recruit diverse talent or diverse suppliers, including, but not limited to:

- Hispanic National Bar Association Annual Convention
- National Black MBA Association, DC Chapter Pre-Conference Career Expo
- National Association of Asian MBAs Annual Leadership Conference
- National LGBT Bar Association Lavender Law Conference
- National Association of Minority and Women Owned Law Firms Annual Meeting
- Minority Corporate Counsel Association Annual Diversity Conference
- Corporate Counsel Women of Color Annual Career Strategies Conference

Cost-Benefit Analyses

We are keenly aware that our rules have both costs and benefits, and that the steps we take to protect the investing public also impact financial markets and industry participants who must comply with our rules. This is truer than ever given the scope, significance and complexity of the Dodd-Frank Act requirements. Our Di-

[67] *See* Release *Authority to Designate Financial Market Utilities as Systemically Important* (July 18, 2011), *http://www.treasury.gov/initiatives/Documents/Finalruledisclaimer7-18-2011.pdf.*

vision of Risk, Strategy, and Financial Innovation ("RSFI") directly assists in the rulemaking process by helping to develop the conceptual framing for, and assisting in the subsequent writing of, the economic analysis sections.

Economic analysis of agency rules considers the direct and indirect costs and benefits of the Commission's proposed regulations against alternative approaches, including, the effects on competition, efficiency and capital formation. Analysis of the likely economic effects of proposed rules, while critical to the rulemaking process, can be challenging. Certain costs or benefits may be difficult to quantify or value with precision, particularly those that are indirect or intangible. In light of recent court decisions, RSFI and the rule writing divisions are examining potential improvements in the economic analysis the SEC employs in rulemaking. Although the existing procedures and policies are designed to provide a rigorous and transparent economic analysis, we are taking steps to improve this process so that future rules are consistent with best practices in economic analysis.

When engaging in rulemaking, the Commission invites the public to comment on our analysis and provide any information and data that may better inform our decisionmaking. In adopting releases, the Commission responds to the information provided and revises its analysis as appropriate. This approach promotes a regulatory framework that strikes the right balance between the costs and the benefits of regulation.[68]

Funding for Implementation of the Dodd-Frank Act

The provisions of the Dodd-Frank Act expand the SEC's responsibilities and will require significant additional resources to fully implement the law. To date, the SEC has proceeded with the first stages of implementation without the necessary additional funding. As described above, implementation up to this point has largely involved performing studies, analysis, and the writing of rules. These tasks have taken staff time away from other responsibilities, and have been done almost entirely with existing staff and without sufficient investments in areas such as information technology.

It is, of course, incumbent upon us to use our existing resources efficiently and effectively as we strive to fulfill statutory mandates, protect investors and achieve our mission. That said, the new responsibilities assigned to the agency under the Dodd-Frank Act are so significant that they cannot be achieved solely by wringing efficiencies out of the existing budget without also severely hampering our ability to meet our existing responsibilities.[69]

If the SEC does not receive additional resources, many of the issues highlighted by the financial crisis and which the Dodd-Frank Act seeks to fix will not be adequately addressed, as the SEC will not be able to build out the technology and hire the industry experts and other staff desperately needed to oversee and police these new areas of responsibility.[70]

The Dodd-Frank Act requires that the SEC collect transaction fees to offset the annual appropriation to the SEC. Accordingly, regardless of the amount appropriated to the SEC, the appropriation will be fully offset by the fees that we collect and therefore will have no impact on the Nation's budget deficits.

Section 967 Organizational Assessment

Section 967 of the Act directed the agency to engage the services of an independent consultant to study a number of specific SEC internal operations. Boston

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[68] After reviewing cost benefit analyses included in six of our Dodd-Frank Act rulemaking releases, the SEC's Inspector General issued a report in June 2011. While the Office of Inspector General ("OIG") is continuing to review the Commission's cost benefit analyses, this report concluded that "a systematic cost-benefit analysis was conducted for each of the six rules reviewed. Overall, [the OIG] found that the SEC formed teams with sufficient expertise to conduct a comprehensive and thoughtful review of the economic analysis of the six proposed released that [the OIG] scrutinized in [its] review." *See* U.S. SEC Office of the Inspector General, *Report of Review of Economic Analyses Performed by the Securities and Exchange Commission in Connection with Dodd-Frank Rulemakings* (June 13, 2011) *http://www.sec-oig.gov/Reports/AuditsInspections/2011/Report_6_13_11.pdf* at 43. We look forward to continuing to work with the OIG as it conducts a further review.

[69] As discussed below, this resource gap was highlighted in the report prepared by the Boston Consulting Group pursuant to Section 967 of the Act.

[70] For instance, the Dodd-Frank Act also established a $50 million SEC Reserve Fund to allow the SEC to invest in multi-year IT projects and respond to unexpected market events (such as the May 6th market plunge). If this fund is eliminated or the SEC is not permitted to access the fund, it would have significant consequences for important IT projects, such as modernizing the SEC's EDGAR system and *www.sec.gov* to strengthen business processes, enhance their usefulness for the public and for SEC staff, and reduce long-term operations and maintenance costs. Without these investments, our ability to resolve longstanding inadequacies in these systems and bring important benefits to the investing public would be significantly hindered.

Consulting Group, Inc. ("BCG") performed the assessment and provided recommendations earlier this spring. Since that time, we have undertaken a comprehensive approach to assessing the recommendations, with the work organized around four principal goals: optimizing the agency's mission and structure; strengthening capabilities; improving controls and efficiency; and enhancing the workforce. Between May and November of this year we have focused on the program infrastructure, and we have created 17 distinct working groups that have analyzed various components of the BCG recommendations. The work streams are led by senior SEC staff members, each tasked with developing the proposed agency approach to a specific BCG recommendation. Additionally, we have created an Executive Steering Committee (ESC) comprised of cross-agency senior leadership to guide the efforts of the work streams, expand the approaches to the broader Commission, and ultimately recommend approval of each approach to me. Many of the working groups currently are preparing recommendations for consideration by the ESC, and we anticipate implementing many of these approaches in early 2012.

We have already made progress on implementing several of the BCG report recommendations, including:

- redesigning the Office of Information Technology to emphasize increased alignment with internal clients, improved coordination with IT groups located within the program offices, and increased efficiencies through centralization of application development and project management;
- establishing a Continuous Improvement Program to systemically reduce unnecessary costs throughout the organization;
- conducting comprehensive assessments of the Office of Administrative Services, Office of Financial Management, and Office of Human Resources operations;
- implementing a new performance management system and conducted extensive staff training to assist with the transition to the new system;
- empowering the Chief Operating Officer (OCOO) by consolidating the former Office of the Executive Director under the OCOO organization; and
- focusing our limited external hiring opportunities on filling strategic, high priority skill vacancies, to include obtaining specialized industry expertise in areas such as over the counter derivatives.

It is important to remember that the BCG study estimated that between $42 and $55 million would be required over an approximately 2-year period to fully implement their recommendations. This cost estimate, however, also does not include the significant amount of SEC staff time that would be needed to accomplish this. We recognize that implementation of many of the ideas in the BCG study will require a long-term commitment and sustained effort over several years to successfully implement. We are committed to an open and transparent process, and consistent with the statute we intend to report to Congress on a regular basis on the actions we take in response to the study.

Conclusion

Though the SEC's efforts to implement the Dodd-Frank Act have been extensive, we know that there is still work left to be done and we are committed to finishing the job. Thank you for inviting me to share with you our progress to date and our plans going forward. I look forward to answering your questions.

PREPARED STATEMENT OF GARY GENSLER

CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION

DECEMBER 6, 2011

Good morning Chairman Johnson, Ranking Member Shelby and Members of the Committee. I thank you for inviting me to today's hearing on implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act. I also thank my fellow Commissioners and CFTC staff for their hard work and commitment on implementing the legislation.

Lessons of 2008

Three years ago, the financial system failed, and the financial regulatory system failed as well. We are still feeling the aftershocks of these twin failures.

There are many lessons to be learned from the crisis. Foremost, when financial institutions fail, real people's lives are affected. More than eight million jobs were lost, and the unemployment rate remains stubbornly high. Millions of Americans

lost their homes. Millions more live in homes that are worth less than their mortgages. And millions of Americans continue struggling to make ends meet.

Second, it is only with the backing of the Government and taxpayers that many financial institutions survived the 2008 crisis. A perverse outcome of this crisis may be that people in the markets believe that a handful of large financial firms will—if in trouble—have the backing of taxpayers. We can never ensure that all financial institutions will be safe from failure. Surely, some will fail in the future because that is the nature of markets and risk. When these challenges arise though, it is critical that taxpayers are not forced to pick up the bill—financial institutions must have the freedom to fail.

Third, high levels of debt—and particularly short-term funding at financial institutions—was at the core of the 2008 crisis. When market uncertainty grows, firms quickly find that their challenges in securing financing, so called problems of "liquidity," threaten their solvency.

Fourth, the financial system is very interconnected—both here at home and abroad. Sober evidence from 2008 was AIG's swaps affiliate, AIG Financial Products, which had its major operations in London. When it failed, U.S. taxpayers paid the price. We must ensure that Europe's ongoing debt crisis does not pose a similar risk to the U.S. economy.

Lastly, while the 2008 crisis had many causes, it is evident that swaps played a central role.

Swaps added leverage to the financial system with more risk being backed by less capital. They contributed, particularly through credit default swaps, to the bubble in the housing market. They contributed to a system where large financial institutions were considered not only too big to fail, but too interconnected to fail. Swaps—developed to help manage and lower risk for end users—also concentrated and heightened risk in the financial system and to the public.

Dodd-Frank Reform

Congress and the President responded to the lessons of the 2008 crisis—they came together to pass the historic Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

The law gave the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) oversight of the more than $300 trillion swaps market. That's over $20 of swaps for every dollar of goods and services produced in the U.S. economy. At such size and complexity, it is essential that these markets work for the benefit of the American public; that they are transparent, open and competitive; and that they do not allow excessive risk to spread through the economy.

The CFTC has benefited from significant public input throughout the rule-writing process. We have received more than 25,000 comment letters. CFTC staff and Commissioners have met more than 1,100 times with market participants and members of the public to discuss the rules, and have held more than 600 meetings with domestic and foreign regulators. We also have conducted 14 public roundtables on Dodd-Frank, many of them with the SEC.

The CFTC has substantially completed the proposal phase of Dodd-Frank rules. We have held 21 public meetings and issued more than 50 proposed rules on the many important areas of reform called for by the new law, including transparency, lowering risk through clearing, market integrity and regulating swap dealers.

The agency turned the corner this summer and began finalizing rules to make the swaps marketplace more open and transparent for participants and safer for taxpayers. To date, we have finished 20 rules, and we have a full schedule of public meetings into next year.

FSOC

To help protect the public, the Dodd-Frank Act included the establishment of the Financial Stability Oversight Council (FSOC). This Council is an opportunity for regulators—now and in the future—to ensure that the financial system works better for all Americans. There has been a tremendous amount of coordination and consultation amongst the eight FSOC agencies on the Dodd-Frank rule-writing process, and the CFTC will continue to work closely with other FSOC members as we finalize additional important rules.

In July, the FSOC approved a rule enabling the Council to identify and designate systemically important financial market utilities, including clearinghouses. Comprehensive and robust regulatory oversight of clearinghouses, in particular their risk management activities, is essential to our country's financial stability. This rule complements the CFTC's final rule establishing risk management and other regulatory requirements for derivatives clearing organizations.

Promoting Transparency

The more transparent a marketplace is, the more liquid it is and the more competitive it is. When markets are open and transparent, prices are more competitive, markets are more efficient, and costs are lowered for companies and their customers. Transparency benefits the entire economy.

To increase market transparency, we have completed rules that, for the first time, provide a detailed and up-to-date view of the physical commodity swaps markets so regulators can police for fraud, manipulation and other abuses. The large trader reporting rule we finalized establishes that clearinghouses and swap dealers must report to the CFTC information about large trader activity in the physical commodity swaps markets. The rule went into effect November 21. For decades, the American public has benefited from the Commission's gathering of large trader data in the futures market, and now will benefit from the CFTC's new ability to monitor swaps markets for agricultural, energy and metal products.

We also finished a rule, which became effective October 31, establishing registration and regulatory requirements for Swap Data Repositories, which will gather data on all swaps transactions. By contrast, in the fall of 2008, there was no required reporting about swaps trading.

Moving forward, we are working to finish rules relating to the specific data that will have to be reported to the CFTC. These reforms will provide the Commission with a comprehensive view of the entire swaps market, furthering our ability to monitor market participants and to protect against systemic risk.

We also are looking to soon finalize real-time reporting rules, which will give the public critical information on transactions—similar to what has been working for decades in the securities and futures markets.

In addition, we are working on final regulations for trading platforms, such as Designated Contract Markets, Swap Execution Facilities and Foreign Boards of Trade—all of which will help make the swaps market more open and transparent. Yesterday, the Commission approved a final rule implementing the Dodd-Frank provision for registration of Foreign Boards of Trade.

Lowering Risk Through Clearing

Another significant Dodd-Frank reform is lowering risk to the economy by mandating central clearing of standardized swaps. Centralized clearing will protect banks and their customers from the risk of a default by one of the parties to a swap. Clearinghouses reduce the interconnectedness between financial entities. They have lowered risk for the public in the futures markets since the late 19th century. In October, we finalized a significant rule establishing risk management and other regulatory requirements for derivatives clearing organizations.

Yesterday, the CFTC approved a final rule enhancing customer protections regarding where clearinghouses and futures commission merchants can invest customer funds. We also are looking to soon finalize a rule on segregation for cleared swaps. Segregation of funds is the core foundation of customer protection. Both of these rules are critical for the safeguarding of customer funds.

In addition, after the first of the year, we hope to consider finalizing rules that will broaden access to the markets, including straight-through processing, or sending transactions immediately to the clearinghouse upon execution; and the exemption for nonfinancial end users. The Dodd-Frank Act does not require nonfinancial end users that are using swaps to hedge or mitigate commercial risk to bring their swaps into central clearing. The law leaves that decision to individual end users. In addition, the CFTC's proposal on margin states that nonfinancial end users will not be required to post margin for their uncleared swaps. Last, the Dodd-Frank Act maintains a company's ability to hedge particularized risk through customized transactions.

Market Integrity

To enhance market integrity, we finished an important rule Congress included in the Dodd-Frank Act giving the Commission more authority to effectively prosecute wrongdoers who recklessly manipulate the markets. The rule, which went into effect August 15, broadens the types of enforcement cases the Commission can pursue and improves the agency's chances of prevailing over wrongdoers. The new authority expands the CFTC's arsenal of enforcement tools so the Commission can be a more effective cop on the beat.

We also finalized a rule to reward whistleblowers for their help in catching fraud, manipulation and other misconduct in the financial markets, which will enhance our ability to protect the public. It went into effect October 24.

In addition, we recently completed speculative position limit rules that, for the first time, limit aggregate positions in the futures and swaps market.

To further enhance market integrity, we are looking to finalize guidance on disruptive trading practices, as well as regulations for trading platforms.

Regulating Dealers

It is also crucial that swap dealers are comprehensively regulated to protect their customers and lower risk to taxpayers.

The CFTC is working closely with the SEC and other regulators to finalize a rule further defining the term swap dealer. We also are planning to finalize a rule on the registration process for swap dealers and major swap participants. The agency is looking to soon consider final external business conduct rules to establish and enforce robust sales practices in the swaps markets. We also will consider final internal business conduct rules, which will lower the risk that dealers pose to the economy. In addition, we have been working closely with other regulators, both domestic and international, on capital and margin rules.

Implementation Phasing

The CFTC has reached out broadly on what we call "phasing of implementation," which is the timeline that our rules will take effect for various market participants. We held a roundtable with the SEC in May to hear directly from the public about the timing of implementation. Prior to the roundtable, CFTC staff released a document that set forth concepts the Commission may consider on effective dates of final rules, and we offered a 60-day public comment file to hear specifically on this issue. The roundtable and public comment letters helped inform the Commission as to what requirements can be met sooner and which ones will take a bit more time.

In September, the Commission issued for public comment a proposal for phasing in compliance with the swap clearing and trading mandates. We also proposed an implementation schedule for previously proposed rules on swap trading documentation requirements and margin requirements for uncleared swaps. These proposals are designed to smooth the transition from an unregulated market structure to a safer market structure. As we progress in finishing major rules, we will continue looking at appropriate timing for compliance, which balances the Commission's desire to protect the public while providing adequate time for industry to comply with these new rules.

In addition, much like we did on July 14, we will soon consider further exemptive relief regarding the effective dates of certain Dodd-Frank Act provisions. Commission staff is working very closely with the SEC on rules relating to entity and product definitions. Staff is making great progress, and we anticipate taking up the further definition of entities in the near term and product definitions shortly thereafter. As these definitional rulemakings have yet to be finalized, the order would provide relief beyond December 31, 2011.

International Coordination

The global nature of the swaps markets makes it imperative that the United States consults and coordinates with foreign authorities. The Commission is actively communicating internationally to promote robust and consistent standards and avoid conflicting requirements, wherever possible. CFTC staff is sharing many of our comment summaries and drafts of final rules with international regulators. We are engaged in bilateral discussions with foreign authorities, and have ongoing dialogues with regulators in the European Union (EU), Japan, Hong Kong, Singapore and Canada. On Thursday, Chairman Schapiro and I will meet with the CFTC's counterparts from these four countries and the EU to discuss how to regulate the global swaps market in a consistent, comprehensive and coordinated manner.

The Commission also participates in numerous international working groups regarding swaps, including the International Organization of Securities Commissions Task Force on OTC Derivatives, which the CFTC co-chairs. In August, the CFTC and SEC staff held a daylong, joint roundtable to discuss international issues related to implementation of Title VII of the Dodd-Frank Act. I anticipate that the Commission will explicitly seek public input on the extraterritorial application of Title VII of the Dodd-Frank Act.

Resources

As the CFTC finalizes these Dodd-Frank rules, the agency will need additional resources consistent with the CFTC's significantly expanded mission and scope. The swaps market is seven times the size of the futures market that we currently oversee.

The agency has the necessary funding to complete rules called for in the Dodd-Frank Act. Moving forward though, the CFTC will need greater resources to protect the public. With just over 700 staff members, we are but 10 percent larger than our peak in the 1990s. Since then, though, the futures market has grown more than

fivefold, and Congress added oversight of the swaps market, which is far more complex and seven times the size of the futures market we currently oversee.

Without sufficient funding for the Commission, the Nation cannot be assured that this agency can oversee the swaps market and enforce rules that promote transparency, lower risk and protect against another crisis.

Conclusion

The CFTC is working to complete our rule-writing under the Dodd-Frank Act thoughtfully—not against a clock.

But until the agency implements and enforces these new rules, the public remains unprotected.

This is why the CFTC is working so hard to ensure that swaps-market reforms promote more open and transparent markets, lower costs for companies and their customers, and protect taxpayers.

Thank you, and I would be happy to take questions.

PREPARED STATEMENT OF MARTIN J. GRUENBERG

ACTING CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

DECEMBER 6, 2011

Chairman Johnson, Ranking Member Shelby and Members of the Committee, thank you for the opportunity to testify on the Federal Deposit Insurance Corporation's continued implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

It has now been nearly 17 months since enactment of the Dodd-Frank Act. The Act gives financial regulators important authorities to enhance financial stability and to manage the regulatory challenges posed by large, complex systemically important financial institutions (SIFIs). The Act also provides for a new SIFI resolution framework that includes an orderly liquidation authority and a requirement for SIFIs to submit resolution plans that demonstrate how they can be resolved through the bankruptcy process. These changes give regulators better tools to manage the potential risks and failure of complex financial institutions. A credible capacity to place a SIFI into an orderly resolution process is essential to subjecting these companies to meaningful market discipline.

The Act specifically provides the FDIC new enhanced authority to manage the deposit insurance fund (DIF) as well as to oversee the orderly resolution of systemically important financial institutions. My testimony today will focus on the progress the FDIC has made in implementing these important provisions of the Dodd-Frank Act, including international efforts on systemic resolution planning. The testimony will also provide an update on implementation of bank capital provisions of the Dodd-Frank Act, as well as an overview of progress on important interagency rulemaking efforts.

Core FDIC Rulemakings

The Dodd-Frank Act granted the FDIC sole rulemaking authority in two primary areas: orderly liquidation authority and deposit insurance reforms. Within a year after passage of the Dodd-Frank Act, the FDIC had completed five major final rules for which the Act granted it sole rulemaking authority.[1] I will discuss these completed rules in more detail below.

Deposit Insurance Reforms and Strengthening the Deposit Insurance Fund

The FDIC moved expeditiously to implement changes to the FDIC's deposit insurance program required by the Dodd-Frank Act. In August 2010, the FDIC issued a final rule to make permanent the increase in the standard coverage limit to $250,000. In December 2010, the FDIC adopted a final rule amending its deposit insurance regulations to provide for unlimited deposit insurance for "noninterest-bearing transaction accounts" through December 31, 2012.

Changing the Assessment Base. In February 2011, the FDIC adopted a final rule redefining the deposit insurance assessment base as average consolidated total

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[1] Two remaining rules have been postponed for practical reasons. First, the rule defining the criteria for consolidated revenues for financial companies predominantly engaged in financial activities has been postponed to ensure consistency with a similar rule being issued by the Board of Governors of the Federal Reserve. Second, the FDIC has postponed the rule offsetting the effect on institutions with less than $10 billion in assets of requiring that the DIF reserve ratio reach 1.35 percent by September 30, 2020 (rather than 1.15 percent by 2016, as previously required) to better enable the FDIC to take into account prevailing industry conditions at the time of the offset.

assets minus average tangible equity. The deposit insurance assessment base was previously defined as domestic deposits.

As Congress intended, the change in the assessment base reduced the share of assessments paid by community banks compared to the largest institutions, which rely less on domestic deposits for their funding than do smaller institutions. Second quarter 2011 assessments for banks with less than $10 billion in assets were about a third (about $340 million) lower in aggregate than first quarter assessments. This shift in the share of assessments better reflects each group's share of industry assets. The change in the assessment base did not materially affect the overall amount of assessment revenue collected. In fact, assessments for the second quarter of 2011 (the quarter when the new rule took effect) were nearly the same as assessments for the prior quarter.

Deposit Insurance Fund Management. Since year-end 2007, 412 FDIC-insured institutions failed resulting in total estimated losses of $86 billion to the DIF. The DIF balance hit a low of negative $20.9 billion in the fourth quarter of 2009. The FDIC took a number of actions to stabilize the DIF and deal with the losses associated with the high volume of failures, including increasing assessment rates, imposing a special assessment and requiring that the industry prepay assessments.

The DIF balance increased throughout 2010 and turned positive again as of June 30 of this year. As of September 30, 2011, the fund balance was $7.8 billion (0.12 percent of estimated insured deposits). The Dodd-Frank Act requires that the DIF reserve ratio reach 1.35 percent by September 30, 2020.

The actions undertaken to stabilize the DIF were taken before passage of the Dodd-Frank Act. The Dodd-Frank Act, however, gave the FDIC enhanced authority to manage the DIF. In particular, the Act gave the FDIC substantial flexibility to set reserve ratio targets and pay dividends. Using this flexibility, the FDIC has adopted a long-term fund management plan designed to maintain a positive fund balance even during a banking crisis while preserving steady and predictable assessment rates through economic and credit cycles. In December 2010, the FDIC set a long-term reserve ratio target of 2 percent. In February 2011, also pursuant to the plan, the FDIC adopted lower assessment rates that will take effect when the DIF reserve ratio reaches 1.15 percent, with progressively lower assessment rates if the reserve ratio exceeds 2 percent or 2.5 percent.

Orderly Resolution of Failed Systemically Important Financial Institutions

In addition to issuing rules to implement deposit insurance and DIF management reforms, the FDIC has made significant progress in adopting regulations and in conducting ongoing planning to facilitate implementation of its new orderly liquidation authority for systemically important financial institutions (SIFIs). These responsibilities include a requirement for firms to maintain resolution plans that will give regulators additional tools to manage the failure of large, complex enterprises, and an orderly liquidation authority to resolve bank-holding companies and, if necessary, nonbank financial institutions.

Orderly Liquidation Authority. Title II of the Dodd-Frank Act vests the FDIC with orderly liquidation authority (OLA) that is similar in many respects to the authorities it already has for insured depository institutions. On July 6, 2011, the FDIC issued a final rule on OLA that provides the regulatory framework defining how creditors will be treated and how claims will be resolved in an FDIC receivership under the Dodd-Frank Act. Many aspects of the process are similar to that in bankruptcy—and creditors will be exposed to losses under the statutory priority of claims. However, unlike bankruptcy, an orderly resolution under the Dodd-Frank Act allows continuity of critical operations both to prevent a freezing-up of the financial system and to maximize the value recoverable from the assets of the failed company. These rules provide the key elements of the framework for implementing OLA, if it is ever necessary.

While the adoption of the final rule completes a large portion of the rulemaking required with respect to the exercise of OLA under the Dodd-Frank Act, there is still work to be done. The FDIC is currently working on other rules and guidance:

- The FDIC is completing a proposed rule to be issued in consultation with the Department of the Treasury regarding certain key definitions for determining which organizations are financial companies within the meaning of the Dodd-Frank Act.
- The FDIC is working with the Securities and Exchange Commission (SEC) on a joint regulation implementing the Title II authority to resolve covered broker-dealers.
- The FDIC is working toward a joint rule ensuring that appropriate records are available with respect to all of a financial institution's derivative transactions.

The FDIC's similar existing regulation requiring troubled insured institutions to maintain records on derivative contracts is being used as a template for this new joint rule.

- The FDIC is working on other rulemakings required by Title II of the Act, including a rule governing eligibility of prospective purchasers of assets of failed financial institutions.
- The FDIC is working on additional guidance to the industry in response to questions and comments received on areas such as the creation, operation, and termination of bridge financial companies, and the implementation of certain minimum recovery requirements established under the Act.

Financial Stability for Systemically Important Financial Institutions

In addition to the FDIC's OLA, the Dodd-Frank Act provided regulators with tools to assist in ensuring financial stability, including the requirement for companies to provide resolution plans, and the authority for certain firms to be designated for oversight by the Board of Governors of the Federal Reserve (FRB).

The Act's provisions are designed so that the OLA would be used only as a last resort. SIFIs and large bank-holding companies are required to prepare a resolution plan that would detail how the firm could be resolved under the Bankruptcy Code. If the firms are successful in their resolution planning, then the OLA would only be used in the rare instance where resolution under the Bankruptcy Code would have serious adverse effects on U.S. financial stability.

Resolution Plans. The FDIC has adopted two rules regarding resolution plans. The first resolution plan rule, jointly issued with the FRB, with an effective date of November 30, 2011, implements the requirements of Section 165(d) of the Dodd-Frank Act. This section requires bank-holding companies with total consolidated assets of $50 billion or more and certain nonbank financial companies that the Financial Stability Oversight Council (FSOC) designates as systemic, to develop, maintain and periodically submit resolution plans to regulators. The plans will detail how each covered company would be resolved under the U.S. Bankruptcy Code, including information on their credit exposure, cross-guarantees, organizational structures, and a strategic analysis describing the company's plan for rapid and orderly resolution.

The resolution planning undertaken in connection with the two rules will complement the internal planning process that the FDIC began upon enactment of the Dodd-Frank Act to prepare for the orderly resolution of a systemically significant institution under the OLA. While the OLA planning process is well underway, and those plans are in an advanced stage of development, they continue to be refined. The information obtained as a result of the resolution plan submissions under the two rules will serve as a significant source of information for the further development of the FDIC's OLA plans.

Submission of resolution plans will be staggered based on the asset size of a covered company's U.S. operations. Companies with $250 billion or more in nonbank assets must submit plans on or before July 1, 2012; companies with $100 to $250 billion or more in total nonbank assets must submit plans on or before July 1, 2013; and all other covered companies that predominantly operate through one or more insured depository institutions must submit plans on or before December 31, 2013. A company's plan is required to be updated annually as well as after a company experiences a material event.

Following submission of a plan, the FDIC and the FRB will review the plan to determine if it is not credible or would not facilitate an orderly resolution of the covered company under the Bankruptcy Code. If a resolution plan does not meet the statutory standards, after an opportunity to remedy its deficiencies, the agencies may jointly decide to impose more stringent regulatory requirements on the covered company. Further, if, after 2 years following the imposition of the more stringent standards, the resolution plan still does not meet the statutory standards, the FDIC and the FRB may, in consultation with the appropriate FSOC member, direct a company to divest certain assets or operations.

The FDIC also issued an Interim Final Rule in September 2011 requiring any FDIC-insured depository institution with assets of $50 billion or more to develop, maintain and periodically submit contingency plans outlining how the FDIC would resolve the depository institution through the FDIC's traditional resolution powers under the Federal Deposit Insurance Act. While not required by the Dodd-Frank Act, this complements the joint final rule on resolution plans for SIFIs.

These two resolution plan rulemakings are designed to ensure comprehensive and coordinated resolution planning for both the insured depository and its holding company and affiliates in the event that an orderly liquidation is required. Both of these resolution plan requirements will improve efficiencies, risk management and contin-

gency planning at the institutions themselves. We expect that the process of developing these plans will be a dialogue between the regulators and the firm. It is not a simple "check-the-box" exercise, and it must take into account each firm's unique characteristics. The planning process must be an interactive dialogue, especially for the largest and most complicated firms. Ultimately, the goal is to have an integrated process of supervision and resolution that will reduce the risk of failure, but that will enable the FDIC to prepare to carry out an orderly resolution if necessary.

The FDIC has initiated with the FRB a series of joint communications that will provide institutions with additional guidance on how initial resolution plans should be drafted. Covered companies have been informed that the planning process will be iterative and that frequent communications are expected as resolution plans are developed.

Implementation of Joint Rules on SIFI Designation. Some of the key purposes of the FSOC, chaired by the Secretary of the Treasury, is to facilitate regulatory coordination and information sharing among its member agencies, to identify and respond to emerging risks to financial stability, and to promote market discipline. The FSOC is also responsible for designating SIFIs for heightened supervision by the FRB.

In October of 2010, the FSOC issued an advanced notice of proposed rulemaking and, in January of 2011, followed up with a notice of proposed rulemaking describing the processes and procedures that will inform the FSOC's designation of nonbank financial companies under the Dodd-Frank Act. In response to concerns raised by commenters, the FSOC issued a second notice of proposed rulemaking and proposed interpretive guidance on October 18, 2011 to clarify the process for SIFI designations, to specify additional details, and to enhance the transparency of the designation process.

The second notice of proposed rulemaking and interpretive guidance supersedes the prior notice of proposed rulemaking, and describes the manner in which the FSOC intends to apply the statutory standards and considerations and the process and procedures that the FSOC intends to follow in making SIFI designations. Under the second notice of proposed rulemaking, nonbank financial companies will generally be assessed using a three-stage process where each stage will involve an increasingly in depth evaluation and analysis. The evaluation will be based on both quantitative thresholds and qualitative factors. The designation process will also analyze the extent to which the company can be resolved in bankruptcy, which is key to whether a company should be designated as a SIFI.

Once designated, SIFIs will be subject to heightened supervision by the FRB and required to maintain detailed resolution plans as discussed above.

International Efforts

In the event of a cross-border resolution of a covered financial company, Section 210 of the Dodd-Frank Act requires the FDIC to "coordinate, to the maximum extent possible" with appropriate foreign regulatory authorities. An important element of the FDIC's implementation of the Dodd-Frank Act has been the creation of a new Office of Complex Financial Institutions. The international outreach and coordination group in this office will coordinate the FDIC's efforts with those in other jurisdictions charged with similar responsibilities.

While no international framework currently exists for the insolvency and resolution of financial institutions, the FDIC and other U.S. regulators have taken the lead in promoting consistent best practices in international insolvencies and resolutions. The structures of international financial companies are often highly complex, and the issues associated with their resolution can be challenging. With planning and cross-border coordination, however, disruptions to global financial markets can be minimized.

The crises in 2008, and the current international instability, demonstrate the necessity for closer cooperation in supervision and in the resolution of cross-border institutions. Given our responsibility for the resolution of a global SIFI, this is a major focus of the FDIC. To achieve this goal, the FDIC and other U.S. regulators are pursuing a number of efforts.

First, the FDIC and its colleagues are working through the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision to promote greater harmonization of national laws governing resolutions and improved coordination. The FDIC co-chairs the Cross-Border Bank Resolution Group (CBRG) of the Basel Committee, which made specific recommendations for reforms to enhance resolution capabilities. These reforms focused on greater legal harmonization, improved information sharing, and market structure enhancements that would make the global financial system more resilient. Last year, the FSB and the G–20 leaders endorsed these recommendations and tasked the CBRG to assess progress. That progress re-

port, released in July, identified a number of areas where significant improvements have been made, but also detailed areas requiring renewed national and international effort.

In October, the FSB released a set of "Key Attributes of Effective Resolution Regimes for Financial Institutions." These Key Attributes build on the CBRG recommendations and expand their scope to include nonbank financial institutions. In fact, the Key Attributes substantively build upon the framework included in the Dodd-Frank Act. Now that the Key Attributes were endorsed by the G–20 last month, all of the major financial centers are required to move toward a resolution framework to resolve systemic financial institutions in an orderly manner that places losses on shareholders and unsecured creditors. A number of key jurisdictions, including the United Kingdom and the European Union, have made significant progress.

Second, the FDIC and its U.S. colleagues are working through Crisis Management Groups (CMGs) for all of the global SIFIs to enhance institution-specific planning for any future resolution. The CMGs allow the regulators to identify impediments to more effective resolution based on the unique characteristics of a particular financial institution. This work, initiated under the auspices of the FSB, has been underway for almost 2 years for the major U.S. and U.K. institutions; other countries are moving rapidly forward as well.

Finally, the FDIC is actively engaged in working with individual foreign regulators to explore more effective means of cooperation. This work entails, initially, gaining a clear understanding of how U.S. and foreign laws governing cross-border institutions will interact in any crisis. The FDIC is working with these regulators to identify the most effective ways to implement the OLA for a U.S. cross-border institution under the host country's applicable laws.

In addition to efforts to achieve harmonization of legal frameworks, the FDIC has been engaged in cooperative resolution planning with supervisory and resolution authorities in foreign countries. In the wake of the financial crisis, there has been an increased international awareness of the need for greater inter-jurisdictional cooperation in the planning for resolution of specific cross-border institutions. Our initial interactions with foreign authorities have proven very promising, and the FDIC will continue to pursue these efforts vigorously.

Similar to the United States, other countries have recognized the need to have a resolution regime separate from the bankruptcy process to resolve large, international financial companies in a manner that can take into account the impact on financial stability.

Promoting Financial Stability by Strengthening Bank Capital. The FDIC strongly supports recent international efforts to strengthen banks' capital adequacy through the Basel III standards and recent agreements regarding capital held by so-called "Global Systemically Important Banks."

The FDIC is working closely with the other Federal banking agencies to complete a notice of proposed rulemaking seeking comment on domestic implementation of the Basel III agreement published by the Basel Committee on Banking Supervision (BCBS) in December 2010. The agencies are also working to finalize changes to the Market Risk Capital Rule agreed to by the BCBS in 2009. The agencies have reached agreement on the notice of proposed rulemaking to implement the internationally agreed changes to the Market Risk Rule in a manner consistent with certain requirements of the Dodd-Frank Act, as described in more detail below. The FDIC Board of Directors is scheduled to consider this proposal tomorrow.

Section 939 of the Dodd-Frank Act requires the agencies to remove references to credit ratings from their regulations. There are many references to credit ratings in the agencies' current capital regulations, as well as in Basel III and the 2009 BCBS reforms to the Market Risk Rules. The agencies' permissible investment regulations also reference credit ratings. Replacing these various references requires the development of credit risk metrics that identify gradations of risk in a consistent and supportable manner, and in a manner that can be reasonably implemented by a wide range of banks. Tomorrow, the FDIC Board will consider a specific proposed alternative to credit ratings that the agencies have developed for use by banks subject to the Market Risk Rule. Developing this proposal has been a challenging task, and marks an important step in fulfilling international regulatory capital agreements in a manner consistent with the Act. The FDIC Board will also be considering a notice of proposed rulemaking regarding permissible investments for savings associations, a rulemaking that will mirror the Office of the Comptroller of the Currency's (OCC) recently published proposal regarding permissible investments for national banks.

Other Rules in Progress

The FDIC is also working with other regulators on implementing several additional important parts of the Dodd-Frank Act.

Volcker Rule. In October, the FDIC, jointly with the FRB, the OCC, and the SEC, issued a notice of proposed rulemaking requesting public comment on a proposed regulation implementing the Volcker Rule requirements of section 619 of the Dodd-Frank Act. The comment period closes on January 13, 2012.

Risk Retention Rule. In March 2011, six agencies, including the FDIC, issued a notice of proposed rulemaking seeking comment on a proposal to implement Section 941 of the Act.[2] The proposed rule would require sponsors of asset-backed securities to retain at least 5 percent of the credit risk of the assets underlying the securities and not permit sponsors to transfer or hedge that credit risk. The proposed rule would provide sponsors with various options for meeting the risk-retention requirements. It also provides, as required by Section 941, proposed standards for a Qualified Residential Mortgage (QRM) which, if met, would result in exemption from the risk retention requirement. During the comment period, which was extended to August 1, 2011, the agencies received numerous comment letters. The agencies are in the process of evaluating those comments.

Margin and Capital Requirements for Covered Swap Entities. In May, the FDIC, jointly with the FRB, the OCC, the Farm Credit Administration, and the Federal Housing Finance Agency (FHFA), published a notice of proposed rulemaking that would impose margin requirements on certain swaps entered into by regulated entities as required under sections 731 and 734 of the Dodd-Frank Act. Since the issuance of the notice of proposed rulemaking, the FSB has initiated an effort to develop an international convergence in margin requirements and has asked the BCBS, in conjunction with the International Organization of Securities Commissions, to develop a consultation document by June 2012. The FDIC, along with the other banking agencies, is actively participating in the FSB initiative. In order to reduce competitive concerns, the agencies have decided to take into consideration, to the extent possible, the margin recommendations developed by this international initiative as they work toward the development of a final rule by mid-2012.

Incentive Compensation. The FDIC continues to work with other agencies, including the Federal banking agencies, FHFA, and the SEC, to implement the incentive compensation requirements in section 956 of the Dodd-Frank Act. Section 956 addresses a key safety and soundness issue that contributed to the recent financial crisis—that poorly designed compensation structures can misalign incentives and promote excessive risk-taking within financial organizations.

In April 2011, the agencies jointly issued a notice of proposed rulemaking that would, among other things, prohibit compensation arrangements that are "excessive" or that "could lead to material financial loss" at a covered financial institution and enhance regulatory reporting of incentive-based compensation arrangements. Section 956 exempts approximately 7,000 institutions with less than $1 billion in total assets from its requirements. For larger institutions, those with $50 billion or more in total consolidated assets, the proposed rule would prescribe payment deferral and other compensation structure requirements for senior policymakers and other key employees.

The agencies are in the process of considering public comments received on the proposed rule.

Consumer Financial Protection Bureau Transition. The FDIC has been working cooperatively with the Consumer Financial Protection Bureau (CFPB) on several transition issues, including supervision and enforcement cases, procedures for consultations on future rulemakings and consumer complaint processing. Several FDIC employees worked temporarily at the CFPB to assist in its startup. The FDIC continues to meet with CFPB officials weekly to establish processes required by the Act, such as the sharing of draft examination reports for institutions where the CFPB has jurisdiction.

Stress Tests. The FDIC has been coordinating with the FRB to develop a proposed rule governing stress tests for financial companies. These tests, required under section 165 of the Dodd-Frank Act, are an essential component of the collective effort to ensure that financial companies have the resilience required to weather a future crisis.

Diversity. The Director of the FDIC's Office of Minority and Women Inclusion is continuing work to develop diversity standards for the FDIC workforce and man-

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[2] The rule was proposed by the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the U.S. Securities and Exchange Commission, the Federal Housing Finance Agency, and the Department of Housing and Urban Development.

agement, and for increased participation of minority- and women-owned businesses in FDIC programs and contracts, as provided in the Dodd-Frank Act. This work continues efforts begun by the Office's predecessor, the FDIC's Office of Diversity and Economic Opportunity.

FDIC Community Banking Initiatives

Given the impact of the recent financial crisis on community banks and concerns raised about the potential effect of the Dodd-Frank Act on these institutions, the FDIC believes that there is value in taking a broad-based look at community banks and the issues that will affect their future. As the primary Federal regulator for the majority of community banks, the FDIC has developed a set of community banking initiatives to further its dialogue with the industry and better its understanding of the challenges and opportunities for community banks.

As part of these initiatives, the FDIC will hold a national conference early next year that will focus on the future of community banks, their unique role in supporting our Nation's economy, and the challenges and opportunities that they face in this difficult economic environment. Following the conference, the FDIC will organize a series of roundtable discussions with community bankers in each of the FDIC's six regional offices around the country in which senior FDIC executives, including myself, will participate.

The FDIC is also undertaking a major research initiative to examine a variety of issues related to community banks, including their evolution, characteristics, performance, challenges, and role in supporting local communities. The FDIC's research agenda will cover topics such as changes in community bank size and geographic concentration over time, measuring the performance of community banks, and changes in community bank business models and cost structures. The research will also look at how trends in technology and the small business economy have affected community banks and the lessons for community banks from the current crisis.

Also as part of these initiatives, the FDIC is continuing to look for ways to improve the effectiveness of its examination and rulemaking processes. The FDIC will seek to identify supervisory improvements and efficiencies that can be made while maintaining our supervisory standards. In particular, the FDIC is exploring enhancements to its offsite reviews, pre-examination planning processes, information requests and examination coordination. In addition, the FDIC is exploring communications strategies to update the industry on upcoming guidance and rulemakings that affect FDIC-supervised community banks in an organized and understandable way so that institutions can more effectively plan to meet their compliance obligations. The FDIC continues to ensure that examination guidance takes into account the size, complexity, and risk profile of each institution. To that end, the FDIC now includes a section in each Financial Institution Letter sent to insured depository institutions that describes its applicability to institutions with total assets of less than $1 billion.

Conclusion

Today's testimony highlights the FDIC's progress in implementing financial reforms authorized by the Dodd-Frank Act. While the FDIC has completed the fundamental rulemakings necessary to fulfill its responsibilities under the Act, there is considerable work to do. Throughout this process, the FDIC has sought input from the industry and the public, has worked cooperatively with fellow regulators, and has been transparent in its deliberations and rulemakings. The FDIC believes that successful implementation of the Act will represent a significant step forward in providing a foundation for a financial system that is more stable and less susceptible to crises in the future, and better prepared to respond to future crises.

Thank you. I would be glad to respond to your questions.

PREPARED STATEMENT OF JOHN WALSH

ACTING COMPTROLLER OF THE CURRENCY
COMPTROLLER OF THE CURRENCY*

DECEMBER 6, 2011

Chairman Johnson, Ranking Member Shelby, and Members of the Committee, I appreciate the opportunity to provide the Committee with a progress report on the initiatives the Office of the Comptroller of the Currency (OCC) has undertaken to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-

*Statement Required by 12 U.S.C. § 250: The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Frank Act or Dodd-Frank) since July 21, 2011. The Committee's letter of invitation requests that I testify about any significant actions and rules proposed or finalized by the OCC since July 21, 2011. In particular, the Committee is interested in hearing about the OCC's progress in carrying out its responsibilities with respect to the Volcker Rule, the integration of the Office of Thrift Supervision (OTS) into the OCC pursuant to Title III of the Dodd-Frank Act, risk retention provisions under Title IX of Dodd-Frank, and the OCC's contributions to the Financial Stability Oversight Council (FSOC) and coordination with other member agencies.

Accordingly, my testimony highlights the OCC's work in the following key areas:

- The integration of the functions of the former OTS with respect to Federal savings associations, and former OTS staff, into the OCC, and the companion effort to integrate, where appropriate, Federal savings association regulations and policies into the regulations and policies for national banks;
- Our efforts to date to work with the Bureau of Consumer Financial Protection (CFPB) as it commences operations;
- An update on the OCC's contributions to, and participation in, the FSOC;
- OCC efforts underway to implement the Dodd-Frank Act provisions that strengthen risk-based capital, leverage, and liquidity requirements; and
- Our progress in regulatory implementation of certain other key Dodd-Frank Act provisions.

I. OTS/OCC Integration

General

On July 21, 2011, Dodd-Frank transferred to the OCC all functions of the OTS relating to Federal savings associations, and the OCC assumed responsibility for the ongoing examination, supervision, and regulation of Federal savings associations. From an operational perspective, the integration of the OTS into the OCC has been successfully completed. We have fully integrated OTS staff into all departments of the OCC's organizational structure. Combined examination teams have begun working on exams at national banks and Federal savings associations. Prior to July 21, 2011, the OCC communicated extensively with the thrift industry to prepare for this transfer of responsibility from the OTS to the OCC. Since that time, we have continued to participate in a variety of outreach activities to maintain an active dialogue with Federal savings associations, including several national teleconferences on supervisory issues of specific interest to them. We also will continue and expand the former OTS advisory committees on mutual savings associations and minority institutions as venues for important input on the unique challenges facing those institutions. And, as new issues emerge, the OCC will continue to communicate regularly with the thrift industry to clarify our expectations and respond to its concerns.

Integration of Regulations

As I explained in my testimony before this Committee in July 2011, the OCC is in the process of undertaking a comprehensive, multi-phased review of its regulations, as well as those of the OTS, to eliminate duplication and reduce unnecessary regulatory burden. On July 21, 2011, the OCC issued a final rule revising certain OCC rules that are central to internal agency functions and operations to take into account the transfer to the OCC of jurisdiction over Federal savings associations. The final rule also conformed the OCC's preemption and visitorial powers regulations to the Dodd-Frank Act provisions that became effective on July 21st. The OCC also issued an interim final rule, effective on July 21, 2011, that republished most OTS regulations in the OCC's chapter of the Code of Federal Regulations and renumbered them accordingly as OCC rules, with nomenclature and other technical amendments to reflect the OCC's responsibilities for Federal savings associations. This action consolidates the regulations applicable to national banks and Federal savings associations in the regulations of the OCC.

We are now in the process of further integrating and consolidating OCC and republished OTS regulations. We are considering more comprehensive substantive amendments to republished OTS regulations, as well as existing OCC rules, with the continuing objective of reducing duplication and providing consistent treatment, where appropriate, for both national banks and Federal savings associations. We expect this process to result in a more streamlined set of regulations that aims to reduce unnecessary regulatory burden. Throughout this process, the OCC is mindful that the Federal savings association charter has certain unique statutory attributes that are necessary to preserve. In all instances where revisions are undertaken, we will seek public comment to assist in making the regulations workable and effective for both national banks and Federal savings associations.

A similar effort is underway to integrate the more than 1,000 OTS supervisory policies into a consolidated OCC policy framework. The goal is to produce a consistent supervisory approach and integrated policy platform for both national banks and Federal savings associations, while recognizing differences anchored in statute. As part of this process, the OCC plans to rescind several hundred OTS documents that are duplicative or obsolete. The OCC will then focus on policy guidance documents that require substantive revision or combination, as well as policy guidance documents that are considered unique to savings associations. Upon completion, this process will result in a more streamlined set of policies for national banks and Federal savings associations that should eliminate confusion associated with duplicative or obsolete policy documents.

Finally, the OCC has worked with the other Federal banking agencies to move savings associations to common financial reporting forms by discontinuing the Thrift Financial Report (TFR), currently used by most savings associations to report financial data, and requiring these institutions to use instead the Consolidated Reports on Income and Condition (Call Reports) filed by banks. The OCC worked with the other banking agencies to reduce confusion and potential burden on savings associations by publishing a number of *Federal Register* notices, posting on the FFIEC and OTS Web sites a "mapping" document that links TFR data items to the appropriate line items in the Call Report, and participating in various industry panel discussions and teleconferences to discuss issues associated with the conversion. Although the agencies recognize that there will be some initial adjustment for savings associations related to this conversion, going forward having a common reporting form and platform provides long-term efficiencies to the agencies and savings associations.

II. Coordination with the Bureau of Consumer Financial Protection

In my previous testimony, I discussed the transition of certain OCC functions and staff to the CFPB, as well as our efforts to assist the CFPB in standing up its operations as of the designated transfer date. We continue to be actively engaged with the CFPB on a number of fronts relating to our respective roles and responsibilities in connection with supervision of compliance by national banks and Federal savings associations with Federal consumer financial laws, processing of related consumer complaints, and consultation on CFPB rulemakings.

There have been significant developments since the last hearing on this matter. Since that time, the CFPB commenced its operations, added staff, and engaged in a number of activities implementing the Dodd-Frank Act. For example, the CFPB has assumed responsibility for conducting examinations for compliance with Federal consumer financial laws at national banks and Federal savings associations with total assets greater than $10 billion and, as of the designated transfer date, the OCC is no longer responsible for such examinations at these institutions. The CFPB also has begun to develop and promulgate certain regulations.

In the last several months, the OCC has assisted the CFPB in a number of areas related to their operations. We have been providing the CFPB with significant staff and infrastructure support by processing consumer complaints on behalf of the CFPB. We entered into a Memorandum of Understanding (MOU) with the CFPB under which the OCC's Customer Assistance Group is performing intake, processing, analysis, and resolution of consumer complaints about national banks and Federal savings associations with total assets of more than $10 billion. The CFPB is currently handling complaints that concern credit cards offered by these large institutions, and plans call for them to begin handling those relating to mortgage lending and servicing this week. The OCC is handling all other complaints, but the MOU provides that the consumer complaint function for large institutions will be assumed in its entirety by the CFPB for all Federal consumer financial laws over the course of the next several months as the CFPB develops the capacity to handle these obligations.

In addition, we recently issued a joint policy statement to clarify how the prudential regulators and the CFPB will measure the total assets of an insured depository institution for purposes of determining supervisory and enforcement responsibilities under the Dodd-Frank Act. Under section 1025 of the Dodd-Frank Act, the CFPB is given primary authority to examine an insured depository institution for compliance with Federal consumer financial laws if the institution has total assets greater than $10 billion. The prudential regulators retain exclusive supervisory and enforcement authority for insured depository institutions with total assets of $10 billion or less. The interagency policy statement describes the agreed-upon measure and a schedule for determining asset size for these purposes by using the total assets reported in four consecutive quarterly Call Reports.

There is much that remains to be done, however. The OCC has established an internal Consumer Issues Steering Committee (CISC) to act as liaison with the

CFPB on the coordination of supervisory and regulatory matters. CISC members have scheduled weekly meetings, and have more frequent informal communications with CFPB staff on examination coordination, information sharing, rulemakings, and consumer compliance issues.

One important project concerns the requirements for consultation by the CFPB with prudential regulators in connection with CFPB rulemakings. Under the Dodd-Frank Act, the CFPB has exclusive authority to prescribe regulations administering certain enumerated Federal consumer financial laws. With respect to this rulemaking authority, the CFPB is required to consult with the prudential regulators prior to proposing a rule and during the rulemaking process "regarding consistency with prudential, market, or systemic objectives" administered by the prudential regulators. The law states that if, during the consultation process, a prudential regulator provides a written objection to all or any part of a proposed CFPB rule under consideration, the CFPB must describe the objection and how it addressed it in its adopting release. This consultation process is important to ensure meaningful input by prudential supervisors on CFPB regulations. The CFPB currently has in process several rulemakings where interagency coordination and consultation will be critical. These include the "ability to repay" requirements for "qualified mortgages," which should be carefully coordinated with the "qualified residential mortgage" criteria in the interagency risk retention rulemaking so that the interplay of the two standards is appreciated and unintended consequences do not result.

The OCC and the other prudential regulators are currently working to develop an agreement on a consultation process that will meet these statutory objectives and provide the prudential regulators with reasonable time to effectively review, discuss, and comment on CFPB rulemakings.

Another area of current discussion concerns implementation of the Dodd-Frank Act requirements that the CFPB coordinate its activities with the supervisory activities conducted by the prudential regulators in order to minimize regulatory burden on an institution. Section 1025 requires the CFPB to consult with the prudential regulators regarding respective schedules for examining an institution. Similarly, the CFPB and the prudential regulators are required to conduct their respective examinations simultaneously in an insured depository institution and to share and comment on related draft reports of examination that result from the simultaneous examinations. The law also provides that the regulated institution may opt out of a simultaneous examination by the prudential regulator and the CFPB.

Candidly, aspects of this portion of the Dodd-Frank Act do not mesh well with how bank examination activities are actually conducted. Therefore, the OCC and the other prudential regulators have initiated efforts to develop a MOU that will implement these coordination requirements in a realistic and practical manner and prevent unnecessary regulatory burden on insured depository institutions—which we believe to have been the Congressional intent. We hope that uncertainty among regulated institutions about when and how they will be examined by the CFPB relative to their examinations by the prudential regulators can be clarified.

III. Activities of the Financial Stability Oversight Council

General

The OCC continues to be an active participant in the activities of the FSOC as it carries out its mission to identify and respond to emerging risks that threaten the financial stability of the United States, to promote market discipline, and to facilitate coordination and information sharing among the various financial regulators.

Since my last update to this Committee in July, the FSOC issued its 2011 Annual Report to Congress, which includes a summary of both the state of the U.S. financial system as a result of the 2007–09 market recession and some of the major forces that will shape the financial system's future development. The report also details the progress of key domestic regulatory reforms resulting from the implementation of the Dodd-Frank Act. In addition, the FSOC has held two formal meetings and convened several conference calls among its members to discuss current market developments. As described in more detail below, formal actions that the FSOC has taken during this period include the publication of an enhanced notice of proposed rulemaking and guidance on the process the FSOC proposes to use for designating systemically important nonbank financial firms for enhanced supervision by the Federal Reserve Board (FRB).

Equally important, however, have been the deliberations and information exchanges among agency principals and staff on market and regulatory developments that could have potential systemic risk implications for the U.S. financial sector and broader economy. These discussions have included updates on the agencies' ongoing assessments and analyses of the situation in the European financial markets and

their potential ramifications for the United States and deliberations on various structural issues confronting the U.S. financial system that were identified in the FSOC's annual report, including money market fund reform, the tri-party repo market, and efforts to address and reform the U.S. housing market. Facilitating these types of candid, confidential exchanges of information is, I believe, one of the most critical functions of the FSOC.

Designations of Nonbank Financial Firms for Heightened Supervision

The FSOC also is continuing its work under the provisions of the Dodd-Frank Act that require the designation of nonbank financial firms for enhanced supervision by the FRB. Based on feedback received on an initial notice of proposed rulemaking issued in January 2011, the FSOC determined that there was a need to seek comment on additional details regarding the standards for this designation process before issuing a final rule. On October 11, 2011, the FSOC issued a second notice of proposed rulemaking and proposed interpretive guidance (NPRM). The NPRM lays out the analytical and procedural framework that the FSOC proposes to use to determine whether a nonbank financial company could pose a threat to the financial stability of the United States.

The NPRM sets forth a three-stage process by which nonbank financial companies generally will be assessed. The FSOC will apply uniform quantitative thresholds in stage 1, as described in the proposed interpretive guidance, to identify companies for further consideration. In stage 2, the FSOC will use information that is available from primary regulators and public information to further analyze the nonbank financial companies identified in stage 1. In stage 3, the FSOC will contact each nonbank financial company that the FSOC believes merits further review to collect information directly from the company that was not available in the earlier stages. At the end of stage 3, based on the results of the analyses conducted during each stage of review, the FSOC may vote to make a determination regarding the company. The comment period for the NPRM closes on December 19, 2011.

IV. Strengthening Capital, Leverage, and Liquidity Requirements

The financial crisis resulted in broad agreement to bolster the quality and quantity of capital held by financial institutions. The G20 has coordinated efforts by other international bodies, such as the Financial Stability Board and Basel Committee on Bank Supervision, to reach consensus on workable and effective enhanced standards. The OCC was actively involved in the development of these international standards through its participation on the Basel Committee and is working with the other U.S. Federal banking agencies to implement Dodd-Frank Act provisions relating to risk-based capital and leverage requirements in a manner that is consistent with those international standards.

In the United States, the Dodd-Frank Act adds heightened prudential standards for all bank-holding companies with more than $50 billion in assets and places floors under the risk-based capital requirements for banks and bank-holding companies. In addition, Dodd-Frank requires all Federal agencies to review any regulation that requires the use of an assessment of creditworthiness of a security or money market instrument and to remove any references to, or requirements of reliance on, credit ratings and substitute such standard of creditworthiness as each agency determines is appropriate. The statute further provides that the agencies shall seek to establish, to the extent feasible, uniform standards of creditworthiness, taking into account the entities the agencies regulate and the purposes for which those entities would rely on such standards.

The Basel Committee revisions that the OCC and the other Federal banking agencies are working to implement in the United States include:

- A new, more rigorous definition of capital, which would exclude funds raised through hybrid instruments that were unable to absorb losses as the crisis deepened;
- Increased minimum risk-based capital requirements, which include increased minimum Tier 1 capital requirements and a new common equity requirement;
- The creation of a capital conservation "buffer" on top of regulatory minimums that would be designed to be drawn down in times of economic stress and would trigger restrictions on capital distributions (such as dividends);
- Enhanced risk-based capital requirements for counterparty credit risk that are meant to capture the risk that a counterparty in a complex financial transaction could grow weaker at precisely the time that a bank's exposure to the counterparty grows larger;
- Revisions to the capital requirements applicable to traded positions, which would broaden the scope of those rules to better capture risks not adequately

addressed under the current regulatory measurement methodologies, including the risk that less liquid products, such as asset-backed securities and re-securitizations, could default or suffer severe losses;

- The creation of a new international leverage ratio requirement to serve as a backstop to the risk-based capital rules. Unlike the current U.S. leverage ratio, the international leverage ratio incorporates off-balance sheet exposures; and
- The adoption of a capital surcharge to be applied to a limited group of global, systemically important banks (G–SIBs), the failure of which would impose outsized costs on the financial system.

Basel III also seeks to address global liquidity concerns arising from the recent financial crisis. These changes would include both a short- and long-term liquidity standard intended to assist a bank in maintaining sufficient liquidity during periods of financial stress. The Basel Committee included a long implementation timeline for both standards to provide regulators the opportunity to conduct further analysis and to make changes as necessary. The long-term standard, which is called the net stable funding ratio or NSFR, is not scheduled to become effective until 2018. The short-term requirement, the liquidity coverage ratio or LCR, is scheduled to go into effect earlier, in 2015. The Federal banking agencies currently are working together to develop and recommend changes to the LCR to ensure that it will produce appropriate requirements and incentives, especially during economic downturns, and to otherwise limit potential unintended consequences.

Harmonizing the Dodd-Frank Act requirements with the revised international standards is one of the principal challenges the OCC and the other Federal banking agencies will face. For example, under the Dodd-Frank Act, the FRB is required to develop and implement heightened prudential standards for bank-holding companies with total consolidated assets over $50 billion, while the Basel Committee's G–SIB surcharge will, in all likelihood, apply to a much smaller subset of much larger banking institutions. In our discussions with the FRB, the OCC has stressed the need to ensure that the heightened prudential standards being developed, including liquidity, and the Basel Committee reforms are carried out in a coordinated, mutually reinforcing manner, so as to enhance the safety and soundness of the U.S. and global banking systems, while not damaging competitive equity or restricting access to credit. Balancing these interests presents a number of challenges that the agencies are continuing to work through.

The Federal banking agencies expect to soon publish proposed revisions to their regulations for determining market risk capital requirements for traded positions. This will be the first risk-based capital proposal to incorporate new nonratings based alternatives developed in response to section 939A.[1] Interweaving all these national and international requirements, and meeting our statutory mandates and our commitments in Basel will be the challenge of the next 6–12 months.

V. Other Rulemakings

The OCC has issued a number of important proposed rules required under the Dodd-Frank Act. This portion of my testimony briefly highlights these proposals and discusses the key issues to be addressed in developing final rules.

Credit Risk Retention Rulemaking

Section 941 of the Dodd-Frank Act requires the OCC, together with the other Federal banking agencies and the Department of Housing and Urban Development, the Federal Housing Finance Agency (FHFA), and the Securities and Exchange Commission (SEC), to require sponsors of asset-backed securities to retain at least 5 percent of the credit risk of the assets they securitize. The purpose of this new regulatory regime is to correct adverse market incentive structures by giving securitizers direct financial disincentives against packaging loans that are underwritten poorly.

Pursuant to this requirement, the interagency group issued a joint proposal. The proposal includes a number of options by which securitization sponsors could satisfy the statute's central requirement to retain at least 5 percent of the credit risk of securitized assets. This aspect of the proposal was designed to recognize that the securitization markets have evolved over time to foster liquidity in a variety of diverse credit products, using different types of securitization structures.

The proposal would also establish certain exemptions from the risk retention requirement, most notably, an exemption for securitizations backed entirely by "quali-

[1] In addition, on November 29, 2011 the OCC published a notice of proposed rulemaking seeking comment on revisions to its regulations pertaining to investment securities, securities offerings, and foreign bank capital equivalency deposits to replace references to credit ratings with alternative standards of creditworthiness. The comment period closes on December 29, 2011. 76 FR 73526.

fied residential mortgages" (QRMs). Consistent with the statutory provision, the definition of QRM includes underwriting and product features that historical loan performance data indicate result in a low risk of default.

The proposal was published in the *Federal Register* on April 29, 2011, and comments were due by June 10, 2011. However, the agencies extended the comment period until August 1, 2011, due to the complexity of the rulemaking and to allow parties more time to consider the impact of the proposal.

The proposal generated substantial interest and attracted thousands of comments on a number of key issues from loan originators, securitizers, consumers, and policymakers. Foremost among these was the role of risk retention, the QRM exemption, and the future role of Fannie Mae and Freddie Mac in the residential mortgage market. Most commenters on the QRM criteria expressed great concern that the QRM criteria were too stringent, particularly the 80 percent loan-to-value requirement for purchase money mortgages. Some commenters also focused on the fact that the proposal would not directly alter the current risk retention practices of Fannie Mae and Freddie Mac, under which they retain 100 percent of the credit risk on their sponsored securitizations in the form of a guarantee and opposed the difference in treatment from private securitizers. Other commenters favored it in recognition of the market liquidity Fannie Mae and Freddie Mac presently provide. The proposed menu of risk retention alternatives also attracted significant comment, supporting the overall approach but also raising numerous specific concerns on the part of securitizers as to whether the particular options would accommodate established structures for risk retention in differing types of securitization transactions.

The agencies are carefully evaluating all of the comments received and are now actively engaged in considering the many issues raised as we determine how best to proceed with the risk retention rulemaking.

Margin and Capital Requirements for Covered Swap Entities

During the financial crisis, the lack of transparency in derivatives transactions among dealer banks and between dealer banks and their counterparties created uncertainty about whether market participants were significantly exposed to the risk of a default by a swap counterparty. To address this uncertainty, sections 731 and 764 of the Dodd-Frank Act require the OCC, together with the FRB, Federal Deposit Insurance Corporation (FDIC), FHFA, and Farm Credit Administration (FCA), to impose minimum margin requirements on noncleared derivatives.

Under the provisions of the Dodd-Frank Act, the OCC, together with the FRB, FDIC, FHFA, and FCA, published a proposal to establish minimum margin and capital requirements for registered swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants (swap entities) subject to agency supervision. The agencies proposed to require swap entities to collect margin for all uncleared transactions with other swap entities and with financial counterparties. However, for low-risk financial counterparties, the agencies proposed that swap entities would not be required to collect margin as long as its margin exposure to a particular low-risk financial counterparty does not exceed a specific threshold amount of margin. Consistent with the minimal risk that derivatives with commercial end users pose to the safety and soundness of swap entities and the U.S. financial system, the proposal also included a margin threshold approach for these end users, with the swap entity setting a margin threshold for each commercial end user in light of the swap entity's assessment of credit risk of the end user. This approach was premised on current market practice, under which derivatives dealers view the question whether to require margin from commercial end users as a credit decision.

The proposal was published in the *Federal Register* on May 11, 2011, and comments were due June 24, 2011. However, due to the complexity of the rulemaking, to allow parties more time to consider the impact of the proposed rule, and so that the comment period on the proposed rule would run concurrently with the comment period for similar margin and capital requirements proposed by the Commodity Futures Trading Commission, the agencies extended the comment period until July 11, 2011.

With very limited exception, commenters strenuously opposed the agencies' proposed treatment of commercial end users. They urged the agencies to implement a categorical exemption, like the statutory exception from clearing requirements for commercial end users. They also indicated that the agencies' proposal on documentation of margin obligations was a departure from existing practice and burdensome to implement. They further indicated that, as drafted, the agencies' proposed threshold-based approach was inconsistent with the current credit assessment-based practices of swap entities.

Another key issue addressed by commenters concerns the proposal's application of margin requirements to foreign branches and affiliates of U.S. banks. The agencies requested comment about a number of specific issues surrounding this topic, including whether it would affect competitive equality with foreign firms. Commenters also strenuously opposed this aspect of the proposal and indicated it would have a severe effect on their competitive position. These commenters noted that U.S. regulators are ahead of their G20 counterparts in formulating margin requirements, and imposition of U.S. margin rules on their foreign derivatives business at a time when their foreign competitors are not required to collect margin from their customers will effectively terminate this aspect of their business. They called for the agencies to delay imposition of this aspect of the proposal and work with foreign authorities to harmonize margin requirements internationally, phasing them in on a coordinated basis.

The agencies are carefully considering all of these issues as we proceed with the design of the rule.

Incentive Compensation Rulemaking

On April 14, 2011, the Federal banking agencies, the National Credit Union Administration (NCUA), the SEC, and the FHFA issued a proposal to implement the incentive-based compensation provisions in Section 956 of the Dodd-Frank Act. The proposal applies to "covered financial institutions" (those with at least $1 billion in assets that offer incentive-based compensation) and has three main components: (1) a requirement that a "covered financial institution" disclose to its regulator the structure of its incentive-based compensation arrangements; (2) standards for incentive-based compensation that are comparable to the safety and soundness standards required under the Federal Deposit Insurance Act; and (3) a prohibition on incentive-based payment arrangements that encourage inappropriate risks by a covered financial institution by providing an executive officer, employee, director, or principal shareholder with compensation that is excessive or that could lead to a material financial loss to the institution.

The material financial loss provision of the proposed rule establishes general requirements applicable to all covered institutions and additional requirements applicable to larger covered financial institutions (which for the Federal banking agencies, NCUA, and the SEC means those covered financial institutions with total consolidated assets of $50 billion or more). The general requirements provide that an incentive-based compensation arrangement, or any feature of any such arrangement, established or maintained by any covered financial institution for one or more covered persons must balance risk and financial rewards and be compatible with effective controls and risk management and supported by strong corporate governance. For larger financial institutions, the proposed rule also mandates deferral and includes a provision concerning individuals who have the ability to expose the institution to possible substantial losses (so called "material risk takers"). These institutions must defer 50 percent of incentive-based compensation for executive officers for at least 3 years, and their boards of directors must identify, and approve, the incentive-based compensation arrangements for material risk takers.

The comment period on the proposed rule closed on May 31, 2011, and the agencies collectively received thousands of comments—approximately 9,700 comments were received by the OCC alone. Among the major issues the agencies are facing are whether to continue to mandate deferral as proposed and whether to revise the material risk taker provision to more clearly delineate the individuals encompassed by the provision and the board of director's responsibilities with respect to these individuals.

Volcker Rule Proposal

On November 7, 2011, the banking agencies and the SEC jointly published a proposal to implement section 619 of Dodd-Frank, also known as the Volcker Rule. Section 619 prohibits "banking entities" (insured depository institutions and any company that controls an insured depository institution) from engaging in proprietary trading and from acquiring or retaining an ownership interest in, sponsoring, or entering into certain relationships with hedge funds and private equity funds. Section 619 expressly exempts certain permitted activities from these prohibitions, including trading in certain Government obligations, underwriting, market-making-related activities, risk-mitigating hedging, trading on behalf of customers, public welfare investments, organizing and offering funds for trust, fiduciary and advisory customers, and trading and fund activities solely outside of the United States. All permitted activities are subject to statutory backstops, regardless of the size of the institution involved, and compliance program requirements may apply as well.

The proposal is the result of months of intensive study and analysis by the agencies of the statutory language of section 619, its legislative history, the FSOC report on the implementation of the Volcker Rule, existing regulatory guidance, and the business practices of banking entities covered by the rule.

The proposal implements the statutory prohibitions and restrictions on proprietary trading and covered fund activities and investments, the related statutory exemptions for permitted activities, and the statutory backstops that apply to all permitted activities. The proposal establishes requirements for engaging in the statutorily permitted activities and interprets many of the exceptions conservatively, including, in particular, the exceptions for underwriting, market-making-related activities, and risk-mitigating hedging. The proposal also defines two key statutory backstops: the prohibitions on engaging in an activity that would involve or result in either a material conflict of interest between the banking entity and its customers, or in a material exposure by the banking entity to a high-risk asset or trading strategy. Banking entities with significant trading activities also are required to report quantitative metrics to help evaluate the extent to which these activities are consistent with permissible market-making-related activities and whether they expose the institution to high-risk assets or trading strategies.

The proposal further requires banking entities engaged in proprietary trading and covered fund activities and investments to develop and implement a compliance program that must address internal policies and procedures, internal controls, a management framework, independent testing, training, and making and keeping of records. The extent of these requirements escalates depending on the volume of the activity. Banking entities with significant trading or covered fund activities or investments must adopt a more detailed compliance program. Banking entities that solely are engaged in activities or in making investments that are permissible under the proposal will still need to satisfy certain compliance requirements designed to assure that their activities are permissible and do not violate any of the statutory backstop standards. Banking entities that do not engage in activities or make investments that are prohibited or restricted by the proposal must also put in place policies and procedures that are designed to prevent them from becoming engaged in such activities or from making such investments without establishing a compliance program required by the proposal.

The proposed rule is open for public comment through January 13, 2012.

Cost-Benefit Analysis

The OCC recognizes the importance of considering the burdens associated with approaches to implementation of Dodd-Frank Act regulatory requirements and the impact of different approaches on smaller institutions. In conjunction with all its rulemakings, the OCC is subject to several standards that require the agency to consider the costs and burdens of the proposed regulation. Since the Committee's last hearing, the Department of the Treasury's Office of Inspector General (IG) completed its review, done at the request of the Ranking Member and other Members of this Committee, of OCC's processes for performing economic analyses in support of our rulemakings and how those processes considered the costs, benefits, and economic impact of certain proposed rules promulgated as a result of the Dodd-Frank Act. On June 13, 2011, the IG issued an informational report on the economic analyses performed by the OCC with respect to three proposed rules. Among other findings, the IG report concluded that "OCC has processes in place to ensure that required economic analyses are performed consistently and with rigor in connection with its rulemaking authority. Furthermore, we found that those processes were followed for the three proposed rules we reviewed."

The OCC conducts analyses to determine the effects and impact of its regulations in accordance with the following three key statutes: the Unfunded Mandates Reform Act, the Congressional Review Act, and the Regulatory Flexibility Act.

Consistent with the Unfunded Mandates Reform Act,[2] the OCC prepares a written statement containing certain information and analysis specified in the statute if a rule contains a Federal mandate that may result in the expenditure by state, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any 1 year.

The Congressional Review Act,[3] generally provides a mechanism for Congressional review of agency regulations by requiring agencies to report to Congress and the General Accountability Office (GAO) when they issue a final rule and by establishing timeframes within which Congress may act to disapprove a rule. The statute requires the Office of Management and Budget (OMB) to determine whether the

[2] 2 U.S.C. §§ 1501 *et seq.*
[3] 5 U.S.C. §§ 801 *et seq.*

final rule is a major rule for purposes of filing a report to Congress (Report to Congress); the OCC provides its views to OMB for consideration as the determination is made. Once this determination is made, the OCC must submit to Congress and the GAO a Report to Congress. As part of the Report to Congress, the OCC must state whether the rule is a "major rule" for Congressional Review Act purposes and must indicate whether the OCC prepared an analysis of costs and benefits.

Finally, with certain exceptions, the Regulatory Flexibility Act[4] generally requires the OCC to review proposed regulations for their impact on small entities and, in certain cases, to consider less burdensome alternatives. After conducting this review, the OCC is required either to prepare and publish a Regulatory Flexibility Analysis or to certify that a Regulatory Flexibility Analysis is not required because the rule will not have a "significant economic impact on a substantial number of small entities."

The OCC also recently responded to a letter from Chairman Johnson requesting, among other things, a description of the OCC's rulemaking process and the economic impact factors considered in OCC rulemakings. Our response to that request includes more detailed information about the procedures staff uses to assess the economic impact in accordance with the statutes described above.

VI. Conclusion

I appreciate the opportunity to update the Committee on the work we have done to implement the provisions of the Dodd-Frank Act, in particular, the completion of a smooth and workable integration of the OTS into the OCC and our progress on the numerous regulatory projects that are ongoing. Much has been accomplished and we will continue to move forward to complete these projects and look forward to keeping the Committee advised of our progress. I am happy to answer your questions.

[4] 5 U.S.C. §§ 601 *et seq.*

RESPONSE TO WRITTEN QUESTIONS OF CHAIRMAN JOHNSON FROM NEAL S. WOLIN

Q.1. In October of last year, the FSOC issued an Integrated Implementation Roadmap for implementing the Wall Street Reform Act. While being respectful of the regulators independence, and the need for quality rules, will FSOC consider issuing an updated roadmap to provide more clarity on when we should expect various important rules to be finalized?

A.1. The integrated Dodd-Frank Act implementation roadmap provided the public with a general guide to the agencies' anticipated timelines and sequence for implementation of Dodd-Frank Act rules. Since the roadmap's release, the Financial Stability Oversight Council's (Council) independent member agencies have engaged extensively with the public to provide further detailed information about the status of their rulemakings, including frequently updating their Web sites as the status of a particular rule or anticipated timeline changes. The Council also has made available on its Web site links to each member agency's Dodd-Frank Act implementation Web page. The Council member agency Web site portal is available at: *http://www.treasury.gov/initiatives/fsoc/Pages/Member-Agency-Dodd-Frank-Act-Portal.aspx.* We expect that agencies will continue to update their implementation timelines as they develop or change.

Q.2. How has financial oversight and the implementation of Wall Street Reform benefited from the formal and informal coordination being done by FSOC?

A.2. The Council has usefully played both formal and informal roles in coordinating the implementation of Wall Street Reform. Most of its members are independent regulators who have specific responsibilities to implement elements of Wall Street reform. In some cases the statute provides a formal role for the Council to consult with rulemaking agencies or for the Secretary, as Chairperson of the Council, to coordinate. For example, the Secretary, as Chairperson of the Council had a coordination role among the six agencies that released a joint rule proposal on credit risk retention and the five agencies that released substantially identical proposals to implement the Volcker Rule. Further, Federal Reserve Board (FRB) staff consulted and coordinated with the Council as the FRB was developing its proposal for enhanced prudential standards and early remediation requirements under sections 165 and 166 of the Dodd-Frank Act. The Council has served as a regular forum for independent agencies to discuss important aspects of Wall Street reform and has created opportunities to share information on key rulemakings.

In addition, the Council has provided a forum for its members to monitor financial market developments and potential risks to fi-

nancial stability. For example, the Council has discussed market developments and potential risks related to the credit ratings of U.S. debt, the failure of MF Global, the sovereign debt crisis in Europe, and trading losses by JPMorgan Chase.

Q.3. Even as the SEC and the CFTC work to consult and harmonize their respective swap rules, it appears that the two agencies do not plan to adopt a joint, integrated and coordinated approach to implementing the new rules. Can the Treasury or FSOC assist in bringing the CFTC and SEC together on adopting a joint implementation plan for derivatives regulation that includes identical or coordinated dates for when the new swap rules go effective?

A.3. Coordination among rulemaking agencies is essential and a particular focus of the Dodd-Frank Act. The Act requires the CFTC and SEC to conduct joint rulemakings to implement certain provisions of Title VII. Other provisions do not require joint rulemakings, but require the SEC and CFTC to treat similar products and entities in a similar manner. Although the SEC and CFTC are independent regulators, they should, wherever possible, have a coordinated and consistent approach to the comprehensive reforms to the derivatives markets in the Dodd-Frank Act. The Council has worked and will continue to work to facilitate coordination and information sharing among its member agencies, including with respect to Title VII implementation.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM NEAL S. WOLIN

Q.1. Secretary Wolin, as Chairman of the Financial Stability Oversight Council, the Treasury Secretary is required to respond to emerging threats to the stability of the U.S. financial system.

What specific actions has Treasury taken to protect the U.S. financial system from a global financial crisis sparked by the ongoing problems in the European Union?

A.1. Secretary Geithner and other senior Treasury officials remain closely engaged with European counterparts. Since the onset of the eurozone crisis, Treasury officials have offered our perspective about the dangers it poses for the global recovery, and we have tried to share the lessons of our own financial crisis about the importance of responding to market challenges decisively and with overwhelming force. U.S. regulators are in active dialogue with our financial institutions to ensure that exposures are being monitored appropriately and to improve their ability to withstand a variety of possible financial contagion stress scenarios emanating from Europe. The Council and its member agencies will continue to carefully monitor the potential risks that could emerge from the European sovereign debt crisis.

The United States has taken a number of actions since the crisis to increase the resiliency of our financial system to shocks from both domestic and external sources. In February 2009, U.S. financial regulators put into place a set of comprehensive stress tests for the 19 largest U.S. bank-holding companies and required 10 of these bank-holding companies to improve the quality and quantity of their capital. As a result, Tier 1 common equity at large bank-

holding companies increased by more than $400 billion to $960 billion from the first quarter of 2009 through the fourth quarter of 2011, a more than 70 percent increase. The Dodd-Frank Act also provides the United States with a new, strong resolution regime for financial companies, and authorizes the FDIC to establish a bridge financial company to facilitate the FDIC's orderly wind down of a failed financial company. We are working through the G–20 and Financial Stability Board to help ensure that major global banks and regulators across the globe develop cross-border recovery and resolution plans by the end of 2012.

Q.2. In questions for the record following the July 21, 2011 Dodd-Frank hearing, I asked you to specify which regulators you were referring to in your *Politico* op-ed, where you stated that "For years regulators in Washington failed to make use of their authority to protect the system." In your response, you did not identify specific regulators that had failed to use the authority that they had to protect the system.

Please identify the specific regulators that you were referring to in your Politico op-ed.

A.2. The failure of regulators prior to the crisis to make use of their authority to protect the financial system was not isolated to a specific agency. Risky practices were allowed that ultimately resulted in a significant cost to our financial system and the broader economy. The financial regulators responsible for consumer financial protection failed both to adopt appropriate rules and to enforce sufficiently existing rules and therefore allowed harmful mortgage lending practices to contribute to the crisis. These authorities have now been consolidated into a single agency with a dedicated consumer focus in the Consumer Financial Protection Bureau.

Q.3. Secretary Wolin, the Dodd-Frank Act requires the Bureau of Consumer Financial Protection to follow Small Business Regulatory Enforcement Fairness Act process known as SBREFA. This process requires the Bureau to convene panels of small businesses to receive their feedback with respect to rulemaking. Earlier this year, the Federal Reserve Board proposed a rule implementing the ability to repay requirements and the Qualified Mortgage exemption under Dodd-Frank. This proposed rule transferred to the Bureau this past July.

Will the Bureau comply with the SBREFA process requirements before finalizing the QM and Ability to Repay rule?

A.3. As you know, the CFPB is an independent Federal regulator within the Federal Reserve System. Section 1100G of the Dodd-Frank Act specifically requires the CFPB to comply with the SBREFA and therefore convene small business review panels before issuing a proposed rule.

The CFPB has acknowledged the need to reach out to small financial service providers to understand the costs and benefits of regulation. One method the CFPB is using to accomplish this, whenever required, is the SBREFA review panel process. The CFPB has already initiated SBREFA review panels for rules to be proposed under TILA and RESPA related to servicing standards and mortgage originator standards.

The ability-to-repay and QM rules were proposed by the Federal Reserve Board, which is not subject to SBREFA. The authority to complete the rulemaking was transferred from the Federal Reserve Board to the CFPB as required by the Dodd-Frank Act. As an independent regulator, the CFPB is responsible for determining compliance with the requirements of the SBREFA for the final rule to implement the ability-to-repay standard and QM definition.

Q.4. Secretary Wolin, you said about the Office of Financial Research (OFR) in testimony earlier this year, "The combination of better, more granular data, and new analytic capabilities focused on systemic threats can help all market participants better understand risks within the financial system."

What sort of data and analytical tools is the OFR using that we did not have leading up to the last financial crisis? How will this help prevent the next crisis?

A.4. The financial crisis exposed critical gaps in data available to policymakers and regulators—for example, a shadow banking system that was relatively unmonitored and exposures of individual financial institutions to their counterparties that were difficult to track. The OFR is working with members of the Financial Stability Oversight Council (Council), their agencies, and their staffs to identify those gaps, recognizing the need to collect only those data that are necessary to monitor threats to financial stability, to avoid redundancies in data collection, and to ensure that sensitive data remain secure. One key step in that process has been to prepare an inventory of data held by the Council's member agencies.

The OFR is also working with policymakers, regulators, and the private sector on establishing a global legal entity identifier (LEI)-a single global standard to identify parties to financial transactions uniquely. This will support better understanding of exposures and interconnections among and across financial institutions-knowledge of which was lacking prior to the crisis.

In addition, the OFR is working with a network of researchers, academics, and practitioners, to strengthen tools for assessing threats to financial stability.

Better data and analysis can support the design of stronger financial shock absorbers and guardrails to reduce the risk of crises. They can also enable earlier warnings and effective responses to mitigate the effects of crises when they do occur and help draw lessons for the future.

Q.5.a. The agencies have submitted a proposed Volcker rule with over 1,300 questions, making it more of a concept release than a proposed rule. Additionally, the CFTC has not yet proposed its version of the Volcker Rule and might offer a competing version.

Given the complexity of the issues involved and that the CFTC has not signed on, do you anticipate extending the comment period?

A.5.a. The comment periods for the proposed rules of all five rulemaking agencies are now complete, including the CFTC's substantially identical proposal. The agencies are now reviewing over 18,000 letters submitted by public commenters. Treasury is actively working with the independent regulatory agencies in their efforts to coordinate and implement the statute effectively.

The Federal Reserve recently issued guidance on the statutory conformance period. That guidance confirms that the Dodd-Frank Act provides entities covered by the Volcker Rule a period of 2 years from the statutory effective date, which would be until July 21, 2014, to fully conform their activities and investments to the requirements of the Volcker Rule provisions of the Act and any final rules implementing those provisions.

The Federal Reserve's guidance states that during the conformance period banking entities should engage in good-faith planning efforts, appropriate for their activities and investments, to enable them to conform their activities and investments to the requirements of the Volcker Rule provisions of the Dodd-Frank Act and final implementing rules by no later than the end of the conformance period.

Q.5.b. Do you anticipate doing a re-proposal?

A.5.b. The five Volcker rulemaking agencies are in the process of reviewing comments in an effort to promulgate a strong, effective Volcker Rule. I am not aware of the need for regulators to do a re-proposal of the Volcker rulemaking.

Q.6. The agencies missed the October 18th statutory deadline for adopting a final Volcker rule, and despite agency delays, the rule is still scheduled to go into effect in July 2012. The Dodd-Frank Act had contemplated at least a 9-month timeframe of advance preparation for compliance.

- Do you believe there will be sufficient time for banking entities to adjust to all of the changes imposed by the rule?
- Would it make sense to phase in the implementation of the rule, so as to identify potential market disruptions caused by any single element of the rule?
- There is ample precedent for a phase-in, such as implementation of Regulation NMS. Do you believe the Volcker Rule calls for a similar phased-in approach?

A.6. The Federal Reserve recently issued guidance on the statutory conformance period. That guidance confirms that the Dodd-Frank Act provides entities covered by the Volcker Rule a period of 2 years from the statutory effective date, which would be until July 21, 2014, to fully conform their activities and investments to the requirements of the Volcker Rule provisions of the Act and any final rules implementing those provisions.

The Federal Reserve's guidance states that during the conformance period banking entities should engage in good-faith planning efforts, appropriate for their activities and investments, to enable them to conform their activities and investments to the requirements of the Volcker Rule provisions of the Dodd-Frank Act and final implementing rules by no later than the end of the conformance period.

The "conformance period" should provide entities covered by the rule sufficient time to implement the rule.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SCHUMER FROM NEAL S. WOLIN

Q.1. As currently proposed, five separate regulators would be responsible not just for rulemaking but also implementation and ongoing supervision and enforcement of the rules adopted under Section 619 of Dodd-Frank. In your opinion, is there potential for inconsistent application of the rules across different markets and product classes? Is any effort being made to create a unified supervision framework?

A.1. The five Volcker rulemaking agencies released substantively identical proposed rules, demonstrating a substantial commitment among agencies to a coordinated approach. The Secretary of the Treasury, as Chairperson of the FSOC, is coordinating the rulemaking implementing the Volcker Rule by the SEC, CFTC, and Federal banking agencies.

Treasury remains committed to working with the rulemaking agencies toward a substantively identical final rule. Moreover, Treasury believes that it is critical for the agencies to work together on "consistent application and implementation" of the Volcker Rule, as the statute provides.

Q.2. The proposed regulatory framework under Section 619 of Dodd-Frank will certainly impact liquidity in the markets for many financial products to some degree. What analysis has been done to estimate the impact in various representative markets (*e.g.,* corporate bonds)? What are the main elements of the proposed rules which you believe mitigate potential harm to market liquidity? To the extent the proposed rules contain such mitigating elements, do you believe those safeguards are adequate?

A.2. The health and liquidity of U.S. capital markets is essential for economic growth. Treasury is committed to effective implementation of the Volcker Rule, including prohibiting proprietary trading while promoting economically important activities that are essential to liquid and efficient capital markets, such as market-making, underwriting, and hedging.

The Council published a study on effective implementation of the Volcker Rule on January 18, 2011, that included perspectives on liquidity in markets, developed on the basis of extensive public comment and outreach to market participants.

The notice of proposed rulemaking requests additional public comment on many aspects of the potential costs and benefits of the proposed rules. As the five rulemaking agencies work through these comments, it is important that they promulgate a final rule that is strong and effective while also protecting the proper functioning of our capital markets.

RESPONSE TO WRITTEN QUESTION OF SENATOR CRAPO FROM NEAL S. WOLIN

Q.1. Last week the House Financial Services Committee passed unanimously a bill that exempts end users from margin requirements. Proposed margin rules ignore the clear intent of Congress that margin should not be imposed on end-user transactions. Do you all agree that end-user hedging does not meaningfully con-

tribute to systemic risk, that the economy benefits from their risk management activity and that they should be exempt from margin requirements, and are you working together to provide consistent rules to provide end users with a clear exemption from margin requirements?

A.1. Although the Department of the Treasury does not regulate the over-the-counter derivatives market, we recognize the importance of appropriate margin requirements and ensuring that end users can continue to prudently hedge risk. The CFTC, the SEC, and the banking agencies are in the process of crafting rules regarding margin requirements, and are focused on adopting requirements that will strengthen the financial system while allowing for proper commercial risk management. Both are essential for economic growth and job creation. Sections 731 and 764 of the Dodd-Frank Act give regulators the flexibility to set margin and capital requirements "appropriate for the risk associated with the noncleared swaps" (and noncleared security-based swaps).

The CFTC and prudential regulators have proposed rules that, in general, would allow commercial end users that operate within established risk limits to enter into noncleared swaps contracts without having to post margin on those contracts—leaving those funds (or assets) free for job creation and investment. The SEC is expected to propose its margin rules in the coming months. The U.S. regulators have been coordinating their efforts in this rulemaking process, including provisions regarding margin requirements. They also held a joint public roundtable on issues related to margin requirements for swaps, including swaps with end-user counterparties.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM NEAL S. WOLIN

Q.1. Under Dodd-Frank, the Volcker rule becomes effective on July 21, 2012 regardless of whether a rule is finalized. Banking entities then have 2 years to come into compliance—July 21, 2014.

- The proposed rule requires conformance "as soon as practicable" after July 21, 2012. Is that consistent with the statute which gives banking entities a full 2 years to come into compliance? What do you mean by "as soon as practicable?" How do banks plan around "as soon as practicable?"
- If the Volcker rule takes effect near or after July 21, 2012, will you give banking entities a reasonable amount of time to digest and come into compliance with the final rule?

A.1. The Federal Reserve recently issued guidance on the statutory conformance period. That guidance confirms that the Dodd-Frank Act provides entities covered by the Volcker Rule a period of 2 years from the statutory effective date, which would be until July 21, 2014, to fully conform their activities and investments to the requirements of the Volcker Rule provisions of the Act and any final rules implementing those provisions.

The Federal Reserve's guidance states that during the conformance period banking entities should engage in good-faith planning efforts, appropriate for their activities and investments, to enable

them to conform their activities and investments to the requirements of the Volcker Rule provisions of the Dodd-Frank Act and final implementing rules by no later than the end of the conformance period.

Q.2. As written, the proposed interagency rule to implement the so-called "Volcker Rule" would impose new and very substantial and costly compliance burdens on many banks that do not have a standalone proprietary trading desk or substantial fund investments, and never have. Specifically, the proposed rule would require these institutions to establish, at a minimum, policies and procedures designed to prevent the occurrence of activities in which the institution is not engaged—in other words, the regulatory equivalent of proving a negative. It sounds to me like that could be a very costly undertaking for an institution that was never the intended target of the Volcker Rule. But more importantly, this makes even less sense given the economic challenges we face and the need to direct resources toward capital planning and lending.

Can you comment on why this is necessary? Is there a less onerous way to implement the permitted activities?

A.2. The statutory text of the Volcker Rule provides for a general prohibition on proprietary trading for all banking entities. The rulewriting agencies have designed a proposed compliance regime for banking entities based on the amount of trading firms engage in and that will provide supervisors with the information necessary to both prevent statutorily prohibited proprietary trading and protect permissible activities like market-making and hedging. This regime has been designed to complement existing compliance programs and risk management systems within large firms with active trading operations, and to have a limited impact on those banking entities that are small or have limited trading activity.

Q.3. Dodd-Frank created the FSOC as a way to make sure all of the regulatory agencies are communicating and rules across the agencies can be as consistent as possible. However, we have seen recently with the release of the Volcker rule by the FDIC, Federal Reserve, OCC and SEC that even with the FSOC and a law that mandates coordination, not all of the agencies can work together.

Despite the new construct, the CFTC is now working on its own rule and has not signed onto the existing rule with the rest of you. Have you all contemplated how it might work to have an individual who handles multiple product lines being forced to adhere to the two different standards? Couldn't that be problematic functionally? Also, do you believe, since the CFTC is going to develop its own rule, we should extend the timeline for implementation so that the interested parties can view ALL of the regulators' proposals and how they will interconnect before filing official comments?

A.3. The five Volcker rulemaking agencies released substantively identical proposed rules, demonstrating a substantial commitment among agencies to a coordinated approach. The Secretary of the Treasury, as Chairperson of the FSOC, is coordinating the rulemaking implementing the Volcker Rule by the SEC, CFTC, and Federal banking agencies.

The comment periods for all five rulemaking agencies are now complete. The agencies are now reviewing over 18,000 letters sub-

mitted by public commenters. Treasury remains committed to working with the rulemaking agencies toward a substantively identical final rule.

Q.4. The new Federal Insurance Office will play a critical role in negotiating with international bodies to ensure that U.S. companies are treated fairly. There are a number of issues that will be debated over the next year including Solvency II and whether the U.S. regulatory system will be deemed equivalent to Europe's. With the U.S. insurance industry being the largest in the world with about $1.6 trillion in premiums, do you believe that FIO has the resources and access to the highest levels at Treasury to adequately represent the United States in these discussions?

A.4. The Federal Insurance Office (FIO) provides the U.S. Government with dedicated expertise regarding the insurance industry. FIO is already playing a number of important roles, including supporting the Financial Stability Oversight Council with expertise on the insurance industry and engaging in international discussions regarding prudential matters in insurance policy.

FIO has the full support and backing of the Treasury Department, and is integrated into the Department structure and its operations. The Treasury Department is committed to building the FIO with appropriate staffing and resources.

Q.5. Follow-up—I understand that your intent is to have FIO be able to adequately represent the United States, so I ask that you report back to us as soon as possible about the status of FIO within the Department of Treasury, where FIO has been placed organizationally, and how FIO can be elevated to ensure it can properly represent the United States in international negotiations.

A.5. FIO is an important office within the Department of the Treasury. FIO is an office within the Office of the Under Secretary for Domestic Finance and, as appropriate, works closely with the Office of the Under Secretary for International Affairs and other offices in Treasury. FIO has assumed a seat on the executive committee of the International Association of Insurance Supervisors (IAIS). FIO is providing important leadership in the EU–U.S. insurance dialogue regarding such matters as professional secrecy and confidentiality standards, group supervision, capital requirements, reinsurance, financial reporting, regulator peer reviews, and independent audit functions. FIO also participated in the recent U.S.-China Strategic and Economic Dialogue in Beijing.

Q.6. To what extent has FIO and the new FIO Director been involved in discussions regarding systemically important financial institutions (SIFIs) in the international arena? I am concerned that international bodies may get out in front of the United States in SIFI designations, and believe that in general, insurance companies are not a systemic risk to the financial system. Had FIO been involved with these talks?

A.6. The IAIS has been charged with recommending insurance institutions of global importance to the Financial Stability Board (FSB). FIO became a full member of the IAIS on October 1, 2011, and joined the IAIS Executive Committee on February 24, 2012. FIO has been working through the IAIS to shape international con-

sensus so that the IAIS designation process, criteria, and timing are consistent with those of the Financial Stability Oversight Council. The IAIS has publicly announced that it will not recommend individual insurers for designation until the end of the first quarter of 2013.

Q.7. FSOC's proposed guidance will initially screen nonbanks for systemic relevance on the same $50bn threshold for banks.

How is this appropriate for the investment fund industry, where assets are managed not owned, and frequently in multiple funds none of which is $50bn but you have to add several funds together to get to the $50bn number?

A.7. The $50 billion threshold in Stage 1 of the Council's analysis applies to firms' total consolidated assets. The Council intends to apply the Stage 1 thresholds to all types of nonbank financial companies, including asset management firms, to identify firms for further evaluation in Stage 2. For purposes of applying the Council's Stage 1 thresholds to separate funds that are managed by the same adviser, the Council's guidance states that the Council may consider the aggregate risks posed by such separate funds, particularly if their investments are identical or highly similar.

The Council recognizes that asset management companies may pose risks that are not well-measured by the quantitative thresholds approach, in part because assets under management are often not included in measures of consolidated assets. As a result, the Council, its member agencies, and the Office of Financial Research are analyzing the extent to which there are potential threats to U.S. financial stability arising from asset management companies. This analysis is considering what threats exist, if any, and whether such threats can be mitigated by subjecting such companies to Federal Reserve supervision and prudential standards, or whether they are better addressed through other regulatory measures. The Council may issue additional guidance for public comment regarding potential additional metrics and thresholds relevant to asset manager determinations, as appropriate.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM DANIEL K. TARULLO

Q.1. Governor Tarullo, the Federal Reserve has recently started taking steps toward greater transparency. For example, the Fed has begun holding press conferences following monetary policy meetings. According to press reports, the Fed will next unveil a new communications policy to improve the clarity of its monetary policy objectives.

- Will the Fed's movement toward transparency be extended to the Fed's bank supervision?
- What steps could the Fed take to make it easier for Congress and the public to assess the Fed's regulation of banks?

A.1. In 2011, the Federal Reserve initiated steps designed to provide greater transparency around our supervision and regulation of the largest, most complex, and systemically critical institutions. A key objective of our supervisory program for these institutions is to ensure they have adequate capital and liquidity to conduct their

operations in a safe and sound manner and to make the adequacy of their capital and liquidity positions transparent to the public. An example of our effort to increase transparency is in the area of our Comprehensive Capital Analysis and Review (CCAR).

The CCAR is a broad supervisory exercise that considers a range of factors that could impact the capital adequacy of these institutions including their internal capital planning process, capital distribution policies, pro forma, post-stress capital ratios, and projected path to compliance with the revised Basel Committee on Bank Supervision regulatory capital standards. Recently, we implemented a capital plan rule that explains our supervisory process for assessing the capital adequacy of CCAR institutions, developed standardized publicly available forms and instructions that identify the specific information we require these institutions to submit, published papers on the CCAR process, and disclosed information on the economic scenarios used in the exercise. We intend to further increase CCAR transparency by providing the public with meaningful summary information on the 2012 CCAR results without violating our commitment to ensure the integrity of confidential supervisory information. As we implement our revised supervisory approach for assessing the liquidity plans of these institutions, we will endeavor to provide a similar level of transparency.

These types of actions are intended to make it easier for Congress and the public to obtain a clear understanding of the effectiveness of our supervisory program without jeopardizing the integrity of the process or disclosing confidential information that would place U.S. institutions at a competitive disadvantage to their international competitors. The Federal Reserve believes a similar level of transparency would be beneficial at systemically critical institutions located in other jurisdictions and is actively working through organizations such as the Basel Committee and the Financial Stability Board to achieve this objective.

Q.2. The agencies have submitted a proposed Volcker rule with over 1,300 questions, making it more of a concept release than a proposed rule. Additionally, the CFTC has not yet proposed its version of the Volcker Rule and might offer a competing version.

- Given the complexity of the issues involved and that the CFTC has not signed on, do you anticipate extending the comment period?
- Do you anticipate doing a re-proposal?

A.2. On December 23, 2011, the Federal Reserve, FDIC, OCC and SEC each acted to extend for an additional 30 days, until February 13, 2012, the public comment period on the proposal to implement section 619 of the Dodd-Frank Act. On January 11, 2012, the CFTC sought public comments on a proposal to implement section 619 of the Dodd-Frank Act that is substantively the same as the proposal published by the Federal Reserve and the other agencies. The Federal Reserve and other agencies will carefully consider the public comments received and take those comments into account in crafting a final rule to implement section 619.

Q.3. The agencies missed the October 18th statutory deadline for adopting a final Volcker rule, and despite agency delays, the rule is still scheduled to go into effect in July 2012. The Dodd-Frank Act

had contemplated at least a 9-month timeframe of advance preparation for compliance.

- Do you believe there will be sufficient time for banking entities to adjust to all of the changes imposed by the rule?
- Would it make sense to phase in the implementation of the rule, so as to identify potential market disruptions caused by any single element of the rule?
- There is ample precedent for a phase-in, such as implementation of Regulation NMS. Do you believe the Volcker Rule calls for a similar phased-in approach?

A.3. As part of the proposed rule, the Federal Reserve and other rule-writing agencies requested comment on potential alternative approaches for compliance with the proposed rule. The proposal specifically requested comment regarding whether a phased-in approach would be more effective than the approach contained in the proposed rule. The Federal Reserve and other agencies will carefully consider all public comments regarding this matter in crafting a final rule to implement section 619.

In addition, the Dodd-Frank Act required the Federal Reserve to issue a final rule implementing the various conformance periods for activities and investments prohibited by the Volcker Rule by January 21, 2011—a date long before the proposal implementing the substantive provisions of the Volcker Rule was due or proposed. In its final rule establishing the conformance periods, the Federal Reserve explained that it would revisit the conformance period rule in light of the requirements of the final rule implementing the substantive provisions of the Volcker Rule. In doing so, the Federal Reserve will carefully consider your suggestions—which have also been noted by other commenters.

In formulating the proposed rule, the agencies sought to limit the potential impact of the proposed rule on small banking entities and banking entities that engage in little or no activity prohibited by the Volcker Rule provisions of the Dodd-Frank Act. In particular, the agencies proposed to reduce the effect of the proposed rule on these banking entities by limiting the application of the reporting, recordkeeping, and the compliance program requirements of the proposed rule, to those banking entities that engage in little or no covered trading activities or covered fund activities and investments. The agencies also requested comment on a number of questions related to the costs and burdens associated with particular aspects of the proposal, as well as on any significant alternatives that would minimize the impact of the proposal on small banking entities. The Federal Reserve will carefully consider the public comments received on these points and take those comments into account in crafting a final rule consistent with the statute.

RESPONSE TO WRITTEN QUESTION OF SENATOR SCHUMER FROM DANIEL K. TARULLO

Q.1. The proposed regulatory framework under Section 619 of Dodd-Frank will certainly impact liquidity in the markets for many financial products to some degree. What analysis has been done to estimate the impact in various representative markets (*e.g.,* cor-

porate bonds)? What are the main elements of the proposed rules which you believe mitigate potential harm to market liquidity? To the extent the proposed rules contain such mitigating elements, do you believe those safeguards are adequate?

A.1. Section 619 of the Dodd-Frank Act prohibits proprietary trading, but provides an exemption for market making-related activities. The implementing rule proposed by the agencies contains the same market making exemption contained in the statute. Consistent with the statutory exemption for market making-related activities, the proposal is designed to permit firms to continue to engage in legitimate market-making activity and provide liquidity in all areas of the trading markets. The proposal is designed to take into account the fact that features of market making activities will vary depending on the type of asset involved and the relative liquidity of a particular market.

For example, the proposal offers a large number of metrics that are proposed to be developed over time and used for the purpose of helping banking firms and supervisors identify trading activity that warrants in-depth review. As explained in the interagency proposal, some metrics may be more useful for a given asset class than others, thereby allowing firms and the agencies flexibility in designing an approach that is most effective in meeting the statutory prohibitions in the Dodd-Frank Act and the exemption for market making-related activities. The agencies have also made clear in their proposal that we intend to take a gradual, heuristic approach to implementing and applying certain supervisory tools, such as metrics, that we have proposed to use to distinguish prohibited proprietary trading from permitted market making, revising and refining those tools during the conformance period so as to ensure they are appropriately tailored and do not chill market liquidity. The Federal Reserve and other rulemaking agencies have requested comment on the potential impact that particular parts of the rule might have on market liquidity and how any negative impacts might be minimized. We will carefully consider the public comments received on these points and take those comments into account, as appropriate, in crafting a final rule to implement section 619.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM DANIEL K. TARULLO

Q.1. Under Dodd-Frank, the Volcker rule becomes effective on July 21, 2012 regardless of whether a rule is finalized. Banking entities then have 2 years to come into compliance July 21, 2014.

- The proposed rule requires conformance "as soon as practicable" after July 21, 2012. Is that consistent with the statute which gives banking entities a full 2 years to come into compliance? What do you mean by "as soon as practicable?" How do banks plan around "as soon as practicable?"
- If the Volcker rule takes effect near or after July 21, 2012, will you give banking entities a reasonable amount of time to digest and come into compliance with the final rule?

- As written, the proposed interagency rule to implement the so-called "Volcker Rule" would impose new and very substantial and costly compliance burdens on many banks that do not have a standalone proprietary trading desk or substantial fund investments, and never have. Specifically, the proposed rule would require these institutions to establish, at a minimum, policies and procedures designed to prevent the occurrence of activities in which the institution is not engaged—in other words, the regulatory equivalent of proving a negative. It sounds to me like that could be a very costly undertaking for an institution that was never the intended target of the Volcker Rule. But more importantly, this makes even less sense given the economic challenges we face and the need to direct resources toward capital planning and lending.

Can you comment on why this is necessary? Is there a less onerous way to implement the permitted activities?

A.1. The Dodd-Frank Act required the Federal Reserve to issue a final rule implementing the various conformance periods for activities and investments prohibited by the Volcker Rule by January 21, 2011—a date long before the proposal implementing the substantive provisions of the Volcker Rule was due or proposed. In its final rule establishing the conformance periods, the Federal Reserve explained that it would revisit the conformance period rule in light of the requirements of the final rule implementing the substantive provisions of the Volcker Rule. In doing so, the Federal Reserve will carefully consider your suggestions—which have also been noted by other commenters.

In formulating the proposed rule, the agencies sought to limit the potential impact of the proposed rule on small banking entities and banking entities that engage in little or no activity prohibited by the Volcker Rule provisions of the Dodd-Frank Act. In particular, the agencies proposed to reduce the effect of the proposed rule on these banking entities by limiting the application of the reporting, recordkeeping, and the compliance program requirements of the proposed rule, to those banking entities that engage in little or no covered trading activities or covered fund activities and investments. The agencies also requested comment on a number of questions related to the costs and burdens associated with particular aspects of the proposal, as well as on any significant alternatives that would minimize the impact of the proposal on small banking entities. The Federal Reserve will carefully consider the public comments received on these points and take those comments into account in crafting a final rule consistent with the statute.

Q.2. FSOC's proposed guidance will initially screen nonbanks for systemic relevance on the same $50bn threshold for banks.

- How is this appropriate for the investment fund industry, where assets are managed not owned, and frequently in multiple funds none of which is $50bn but you have to add several funds together to get to the $50bn number?

A.2. The FSOC has acknowledged in various statements that the same measurements of the size of an organization may not be appropriate for identifying the risk that organizations in different in-

dustries pose to the financial system. Indeed, in the preamble to its second notice of proposed rulemaking and proposed interpretive guidance, the FSOC recognized the need for further analysis of appropriate metrics for identifying the potential systemic risks posed by asset management companies and indicated its intent to consider whether asset management companies could in fact pose a threat to U.S. financial stability, the extent of any such threats, and whether such threats could be mitigated by subjecting these companies to Board supervision and prudential standards, or whether these threats would be better mitigated through other regulatory measures. The FSOC indicated that it may develop additional metrics and thresholds more appropriate for identifying asset management companies for further review.[1]

The FSOC also specifically noted that because a limited amount of data is currently available about hedge funds and private equity firms, it may establish additional metrics or thresholds tailored to evaluate these firms once these firms are required to provide data about their operations to the Securities and Exchange Commission, beginning in 2012, and this data becomes available for evaluation by the FSOC.

As a member agency of the FSOC, the Board is continuing to work with the FSOC and its member agencies to establish a methodology to identify systemically important nonbank financial companies.

RESPONSE TO WRITTEN QUESTION OF SENATOR CRAPO FROM DANIEL K. TARULLO

Q.1. Last week the House Financial Services Committee passed unanimously a bill that exempts end users from margin requirements. Proposed margin rules ignore the clear intent of Congress that margin should not be imposed on end-user transactions. Do you all agree that end-user hedging does not meaningfully contribute to systemic risk, that the economy benefits from their risk management activity and that they should be exempt from margin requirements, and are you working together to provide consistent rules to provide end users with a clear exemption from margin requirements?

A.1. Although section 723 of the Dodd-Frank Act provides an explicit exemption for certain end users from the swap clearing requirement, there is no exemption from the margin requirement in section 731 or section 764 of the Act for a swap dealer's or major swap participant's (MSP's) swaps with end users. Sections 731 and 764 of the Act require the CFTC, SEC, Board, and other prudential regulators to adopt rules for swap dealers and MSPs imposing initial and variation margin requirements on all noncleared swaps. The statute directs that these margin requirements be risk-based.

The prudential regulators' proposed rule implementing sections 731 and 764 follows the statutory framework and proposes a risk-based approach to imposing margin requirements for transactions with nonfinancial end users. Nonfinancial end users appear to pose minimal risks to the safety and soundness of swap dealers and to

[1] *See* 76 FR 64264 (2011).

U.S. financial stability when they hedge commercial risks with derivatives and the related unsecured exposure remains below an appropriate credit exposure threshold. Accordingly, the proposed rule does not specify a minimum margin requirement for transactions with nonfinancial end users. Rather, the proposed rule, consistent with long-standing supervisory guidance, would permit a swap dealer to adopt, where appropriate, its own thresholds below which the swap dealer is not required to collect margin from counterparties that are nonfinancial end users. Such thresholds would be set forth in a credit support agreement and approved and monitored by the swap dealer as part of its own credit approval process.

In issuing the proposal, the prudential regulators requested comment on a number of questions related to the effect of the proposed margin requirements on nonfinancial end users, including whether alternative approaches are preferable. We have received a variety of comments from members of the public, including commercial firms that use swaps to hedge their risk. Some of these comments have raised concerns regarding aspects of the proposed rule that commenters believe (i) would be inconsistent with current market practices with respect to nonfinancial end users and/or (ii) would have a negative impact on commercial firms and their use of derivatives to hedge. The prudential regulators are carefully considering all comments, and coordinating with the CFTC and the SEC, as we evaluate the proposal in light of comments received and formulate a final rule, as required by statute.

RESPONSE TO WRITTEN QUESTIONS OF CHAIRMAN JOHNSON FROM MARY L. SCHAPIRO

Q.1. How has financial oversight and the implementation of Wall Street Reform benefited from the formal and informal coordination being done by FSOC?

A.1. Financial oversight and implementation have benefited tremendously from the formal and informal coordination being done by FSOC.

Formally, the FSOC has established several staff committees and workstreams made up of staff at its member agencies to address a variety of topics, including a study of the Volcker Rule; the identification of potential risks that flow across the financial system; the publication of the FSOC annual report; and consideration of processes for the designation of financial market utilities and nonbank financials for heightened review by the Federal Reserve.

Just as important, I believe has been the progress made through informal coordination. By its very existence and unique mission, the FSOC has helped foster far greater communication between regulatory agencies—both at the principal level and at the staff level—about risks to the financial system and about more traditional regulatory efforts. These informal contacts have helped speed interactions, break down traditional silos, and substantially improved information sharing among the agencies and I believe all for the better.

Q.2. The Securities Subcommittee recently held a hearing with the SEC Division Directors to discuss recent problems reported at the

SEC. Since that hearing, what changes are you making at the SEC to improve its operations?

A.2. As our Division Directors testified in that November hearing, a significant amount of work has gone on at the SEC in the last 3 years to improve our operations. As one highlight, the GAO's audit of the SEC's FY 2011 financial reports found that the SEC had succeeded in eliminating both of the two material weaknesses in its internal controls. Our staff has been working tirelessly to tackle longstanding issues in this area, and I am very proud of these results.

As another example, the SEC's Office of Compliance Inspections and Examinations ("OCIE") continues to implement the improvement plan that was a result of OCIE's self-assessment of the best way to improve process, strategy, structure, people and technology. The improvement plan initiatives are in various stages of development as OCIE moves forward with changes on a number of fronts. Since the November testimony, OCIE has implemented a couple of significant new improvements:

- On January 3, 2012, OCIE nationally implemented its electronic examination workbook, the Tracking and Reporting Examinations National Documentation System ("TRENDS"), for all staff to use when conducting examinations of investment advisers and investment companies. TRENDS is a Web-based program that creates a uniform examination process and record-retention function for the National Examination Program, and streamlines the examination process to enable examiners to more efficiently carry out their examination-related responsibilities.
- On January 17, 2012, the National Examination Program implemented a single comprehensive Inspections and Examinations Program Manual. The Manual represents the culmination of 15 months of work to review more than 200 NEP policies, identify policies that were no longer in effect or out of date, and capture the elements of those policies that were critical for the effective operation of the National Examination Program. We recognize that a comprehensive manual that allows all examination staff to have a common set of standards is critical to establishing a high performing and compliant organization.

The OCIE reforms are bearing results, including improved actionable information for enforcement investigations.

Furthermore, the structural reforms undertaken by our enforcement program are bearing fruit. In FY 2011, the Commission filed 735 enforcement actions—more than ever filed in a single year in SEC history. The SEC was better able to discover and stop illegal activity earlier and obtained more than $2.8 billion in penalties and disgorgement ordered. Among the cases filed in FY 2011 were 15 separate actions related to the financial crisis, naming 17 individuals, including 16 CEOs, CFOs, and other senior corporate officers. To date, the SEC has filed financial crisis-related actions against 95 individuals and entities, naming nearly 50 CEOs, CFOs, and other senior corporate officers. In FY 2011, the number of enforcement actions related to investment advisers and broker-deal-

ers also grew, with a total of 146 enforcement actions filed related to investment advisers and investment companies, a single-year record and 30 percent increase over FY 2010. The SEC also brought 112 enforcement actions related to broker-dealers, a 60 percent increase over last fiscal year.

Q.3. Does your agency take economic impact analysis seriously in your rules? If so, please discuss if there are any barriers to better analysis, such as your agency's funding or ability to collect data from stakeholders who may be reluctant to share that information.

A.3. High-quality economic analysis is an essential part of SEC rulemaking. The Commission has long recognized that a rule's potential benefits and costs should be considered along with the protection of investors in making a reasoned determination that adopting a rule is in the public interest.

When proposing a rule, the Commission engages in cost-benefit analysis and invites the public to comment on its analysis and provide any information and data that may better inform its decision-making. In adopting releases, the Commission responds to the information provided and revises its analysis as appropriate. This approach promotes a regulatory framework that strikes an appropriate balance between the costs and the benefits of regulation.

In some cases, economic impact analysis is specifically required by statute. For example, the securities laws require the Commission, when it engages in rulemaking and is required to consider or determine whether the rulemaking is in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[1] Section 23(a) of the Exchange Act also requires the Commission, in making rules and regulations pursuant to the Exchange Act, to consider among other matters the impact any such rule or regulation would have on competition. The agency may not adopt a rule under the Exchange Act that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Act. In addition, the Commission considers the economic impact of its rules pursuant to requirements under the Regulatory Flexibility Act, the Paperwork Reduction Act, and the Small Business Regulatory Enforcement Fairness Act of 1996.

The Commission also considers the costs and benefits of rules as a regular part of the rulemaking process. We are keenly aware that our rules have both costs and benefits, and that the steps we take to protect the investing public impact both financial markets and industry participants who must comply with our rules. This is especially relevant given the scope, significance, and complexity of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). Our Division of Risk, Strategy, and Financial Innovation ("RSFI") directly participates in the rulemaking process by helping to develop the conceptual framing for, and assisting in the subsequent writing of, the economic analysis sections of the Commission's rulemaking releases.

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[1] *See* Securities Act § 2(b); Exchange Act § 3(f); Investment Company Act § 2(c); and Advisers Act § 202(c).

Certain costs or benefits may be difficult to quantify or value with precision, particularly those that are indirect or intangible.[2] The primary difficulties can be traced to the absence of suitable data. This situation often arises in rulemaking because many rules are designed to modify the behavior of market participants in response to perceived problems. When there are no precedents that can be used as a basis for analysis, it is impossible to rigorously predict anticipated responses to proposed regulations. In addition, relevant data are only available from certain market participants. During the comment process, the SEC may ask the public to quantify their estimates of cost and benefits, especially when the dollar costs of proposed rulemaking are known only to or best determined by market participants. Although this can be an effective method for obtaining data, some firms are reluctant to provide information that is proprietary or confidential. Further, the process of providing the data may be burdensome to the individuals and firms and such data may be biased in favor of the respondent's preferred outcome.

The Commission's ability to gather data for use in its cost-benefit analysis also is constrained in some respects by administrative laws, such as the Paperwork Reduction Act, although the Dodd-Frank Act provides the Commission with some relief from the data gathering constraints of the Paperwork Reduction Act in the rulemaking context.[3]

In light of recent court decisions, RSFI and the rule writing divisions, together with the Office of General Counsel, are examining improvements in the economic analysis the SEC employs in rulemaking. Although the existing processes are designed to provide a rigorous and transparent economic analysis, we are taking steps to improve this process so that future rules are consistent with best practices in economic analysis.

Q.4. Even as you work to consult and harmonize the swap rules, it appears the SEC and CFTC do not plan to adopt a joint, integrated and coordinated approach to implementing the new rules. What can be done to ensure that the SEC and CFTC move together to issue an implementation plan for public comment that includes identical or coordinated dates for when the new rules go effective?

A.4. The Dodd-Frank Act calls for the CFTC and the Commission to consult and coordinate for the purposes of assuring regulatory consistency and comparability to the extent possible. The Dodd-Frank Act also calls on the agencies to treat functionally or economically similar products or entities in a similar manner, but does not require identical rules.

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[2] In its report discussing cost-benefit analyses of Dodd-Frank Act rulemaking by financial regulators, the GAO noted that "the difficulty of reliably estimating the costs of regulations to the financial services industry and the Nation has long been recognized, and the benefits of regulation generally are regarded as even more difficult to measure." GAO–12–151, p. 19; see also GAO–08–32.

[3] Securities Act Section 19(e), as added by Section 912 of the Dodd-Frank Act, provides that, for the purpose of evaluating any rule or program of the Commission issued or carried out under any provision of the securities laws and the purposes of considering proposing, adopting, or engaging in any such rule or program or developing new rules or programs, the Commission may: (1) gather information from and communicate with investors or other members of the public; (2) engage in such temporary investor testing programs as the Commission determines are in the public interest or would protect investors; and (3) consult with academics and consultants. Securities Act Section 19(f) provides that any action taken under Section 19(e) will not be construed to be a collection of information for purposes of the Paperwork Reduction Act.

Commission staff has consulted extensively with the CFTC in the development of our proposed rules. Our objective has been to establish consistent and comparable requirements, where possible, given the differences in the swap and security-based swap markets. The Dodd-Frank Act's application to security-based swaps may differ from its application to the swaps regulated by the CFTC, as the relevant products, entities and markets themselves are different. Given this, differing approaches to the new requirements applicable to swaps and security-based swaps pursuant to the Dodd-Frank Act—including the timing of compliance with such requirements—may be warranted in some instances.

As we have previously announced, the Commission intends to seek public comment on an implementation plan that will aim to permit the roll-out of the new security-based swap requirements in a logical, progressive, and efficient manner while minimizing unnecessary disruptions and costs to the markets. We will continue our efforts to coordinate as much as practicable with the CFTC as we move toward the publication of this implementation plan.

Q.5. Congress created a new whistleblower program to encourage private citizens to bring quality tips of securities law violations to the attention of the SEC. Has this helped bring better quality information to the attention of the SEC enforcement staff to prosecute wrongdoers?

A.5. Section 922 of the Dodd-Frank Act established a whistleblower program that requires the SEC to pay an award to eligible whistleblowers who voluntarily provide the agency with original information about a violation of the Federal securities laws that leads to a successful SEC enforcement action. The Act also required the Commission to promulgate rules to implement the program. Our final rules, adopted in May 2011, became effective on August 12th. Since then, the Commission has received hundreds of tips through the whistleblower program from individuals all over the country and in many parts of the world. That, of course, is in addition to the tens of thousands of tips, complaints, and referrals the agency receives every year.

We are indeed reaping the early benefits of the whistleblower program through active and promising investigations utilizing crucial whistleblower information, some of which may lead to rewards in the near future. Though some expressed concern that the Commission will be inundated with low-quality submissions, to date, the contrary is proving to be the case. We continue to see an uptick in higher quality submissions, including potential violations that would have been difficult to detect or which otherwise may never have come to light without the assistance of the whistleblower. In addition, the quality of the information we are receiving has, in many instances, enabled our investigative staff to work more efficiently, thereby allowing us to better utilize our resources.

Our new Office of the Whistleblower is reviewing these submissions and working with whistleblowers. The office recently filed its Annual Report to Congress detailing its many activities since its

creation.[4] These include, among other things, the establishment of an outreach program, internal training programs, creation of policies and procedures, meetings with whistleblowers and their counsel, and coordination on investigations with Commission staff. The report also includes information about the number and types of whistleblower tips and complaints the agency has received since the rules became effective.

Q.6. There have been several questions raised about the scope of the SEC's proposed rule to implement provisions of Section 975 of the Wall Street Reform and Consumer Protection Act. Can you please provide an update on where this rulemaking stands? How are you responding to concerns that the proposed rule is broader than Congress intended?

A.6. As you know, Section 975 of the Dodd-Frank Act amended Section 15B of the Exchange Act to require registration as a "municipal advisor" of any person that provides advice to a municipal entity with respect to municipal financial products or the issuance of municipal securities. On September 1, 2010, the Commission adopted an interim final temporary rule that established a procedure for advisors to temporarily satisfy the registration requirement as a transitional step toward the implementation of a permanent registration regime. The temporary rule is currently set to sunset on September 30, 2012. A municipal advisor that has completed the temporary registration form and received confirmation from the Commission that the form has been filed temporarily satisfies the registration requirement. The Commission has received approximately 1,000 confirmed registrations, including approximately 300 from registered broker-dealers.

In addition, on December 20, 2010, the Commission proposed for public comment rules that would govern the registration of municipal advisors and, among other things, proposed guidance and solicited comments on many important issues. We have received over 1,000 comment letters on the proposal, and are reviewing them carefully. We expect to adopt final rules for the registration of municipal advisors later this year.

We greatly appreciate these comments, including comments from the banking industry, public officials, market participants and Members of Congress, as the comments are helping us to formulate final rules that thoroughly consider the costs and benefits to investors, municipal entities, and obligated persons. In addition to reviewing the many comments received, Commission staff is consulting with staff at other regulators, market participants and other stakeholders regarding the appropriate scope of the definition of municipal advisor. This consultation should help promote a more effective and efficient implementation of the requirements of the Dodd-Frank Act that protects investors, municipal entities, obligated persons, and the public interest. The Commission expects that the final rule will strike an appropriate balance between ensuring that parties engaging in municipal advisory activities are registered, without needlessly requiring regulated persons already

[4] *See* U.S. Securities and Exchange Commission Annual Report on the Dodd-Frank Whistleblower Program, Fiscal Year 2011 (November 2011), available at *http://www.sec.gov/about/offices/owb/whistleblower-annual-report-2011.pdf.*

under the jurisdiction of Federal and state governmental agencies and self-regulatory organizations to comply with additional regulation, examination and inspection burdens.

Q.7. Once the definition of a municipal advisor is completed, the SEC and the MSRB then have to flesh out the regulatory regime that applies to currently unregulated municipal advisors. What kind of framework do you intend to apply to municipal advisors not employed by underwriters?

A.7. Once the definition of a municipal advisor has been finalized, the Commission expects that the MSRB will propose several rule changes relating to the regulation of municipal advisors, including a proposal that would prohibit "pay-to-play" practices by municipal advisors, as well as proposals that would impose uniform standards for the training and conduct of municipal advisors. Like all self-regulatory organization rules, any proposals relating to the regulation of municipal advisors will be subject to public notice and comment, as well as Commission review.

The municipal advisor regulatory framework will apply to all "municipal advisors", as that term is defined in Section 15B of the Exchange Act and rules or regulations promulgated thereunder. Thus, without other action, this framework would be applicable to municipal advisors not employed by underwriters.

Q.8. The sharing of swap data among international and domestic regulators is critical to reducing systemic risk in the global derivatives market. Could you describe how the SEC plans to further the goal of allowing U.S. and international regulators the ability to share swap data, and the types of international swap data sharing arrangements the United States plans to enter into with other financial regulatory authorities? Also, how will these international swap data sharing arrangements address the indemnification provisions contained in Title VII of the Wall Street Reform Act, and do you anticipate any challenges in implementing effective data sharing arrangements with international regulators resulting from such indemnification provisions that cannot be addressed through SEC "exemptive authority," powers granted under Section 752 of the Wall Street Reform Act, or other authorities provided to your agency?

A.8. The Commission and other regulators should have access to data pertaining to transactions and participants in the OTC derivatives markets that they oversee. By having access to such data, regulators will be in a better position to, among other things, monitor counterparties' exposure to risk, identify concentrations of risk exposures, and evaluate systemic risks.

The system that the Dodd-Frank Act (DFA) established to govern access by relevant foreign and domestic regulators to Security Based Swap (SBS) data relies primarily on Security Based Swap Data Repositories (SBSDR) making this information directly available to these regulators. Specifically, the DFA requires all cleared and uncleared SBSs to be reported to a SBSDR registered with the Commission or, if the SBS is uncleared and no SDR will accept the SBS, to the Commission.

DFA Section 763(i) requires SBSDRs to share this SBS data, on a confidential basis, directly with certain domestic and foreign reg-

ulators and other parties that the Commission deems appropriate, provided that certain criteria are met, including notice to the Commission of the SBSDR's receipt of a request for information. Pursuant to DFA Section 763(i), among other things, the SBSDR is required to obtain an agreement from the requesting regulator or third party stating that the requesting party will indemnify the Commission and the SBSDR for litigation expenses related to the SBSDR's sharing of information with the requesting party (Indemnification Provision).

Indemnification Provision

As reflected in the SEC's proposed rule regarding Security-Based Swap Data Repository Registration, Duties, and Core Principles (SBSDR Proposed Rules),[5] the Indemnification Provision raises several challenges with respect to an SDR's ability to share SBS data with domestic and foreign counterparts. First, foreign regulators, as is the case with the SEC, may be legally prohibited or otherwise restricted from agreeing to indemnify third parties, including SBSDRs and the Commission. Second, the Indemnification Provision could chill other regulators' requests for access to data held by SDRs, thereby hindering their ability to fulfill their regulatory responsibilities. Foreign authorities have expressed these concerns about the potential effect of the Indemnification Provision.

In the SBSDR Proposed Rules, the Commission highlighted two ways in which foreign regulators could obtain data maintained by SBSDRs without providing indemnification. First, as the Commission pointed out in proposing the SBSDR Proposed Rules, the Commission has general authority under the Section 24 of the Exchange Act to share nonpublic information in its possession with both domestic and foreign authorities and regulators. The Commission also has specific authority under Section 21(a) of the Exchange Act to help foreign authorities investigate matters that pertain to their oversight duties. The Indemnification Provision would not apply to a Commission decision to assist foreign regulators under Section 21(a) or to share SBS data in the Commission's possession with foreign regulators pursuant to Section 24 of the Exchange Act, as discussed above.

Furthermore, the Indemnification Provision need not apply where a U.S.-registered trade repository is separately registered in a foreign jurisdiction. Under such a circumstance, the foreign supervisor of the U.S.-registered trade repository should have direct access to information held in the repository pursuant to the law of that foreign jurisdiction, provided that applicable U.S. statutory confidentiality provisions are met.

International SBS Data Sharing Arrangements

The Commission may enter into a broad array of arrangements with regard to the sharing of SBS data, including memoranda of understanding, pacts, exchange of letters, protocols and undertakings. In the enforcement context, the Commission derives its ability to conclude reciprocal arrangements with foreign counterparts from statutory sources that: (i) allow the Commission to pro-

[5] November 19, 2010, available at *http://www.sec.gov/news/press/2010/2010–229.htm.*

vide enforcement and supervisory assistance to foreign securities authorities;[6] (ii) permit certain high-level Commission officials to share confidential information with certain types of entities at the Commission's discretion; and (iii) allow the Commission to avoid compulsory disclosure of records provided to the Commission by foreign securities authorities.

Since the late 1980s, the Commission successfully has used information-sharing arrangements to facilitate cooperation with its foreign counterparts. To date, the Commission has entered into around 40 memoranda of understanding with foreign securities authorities related to enforcement and supervisory cooperation.[7] In addition, the Commission is a signatory to the IOSCO Multilateral Memorandum of Understanding, pursuant to which the Commission shares information with foreign regulators in 80 countries.

The Commission staff believes that many of these agreements could serve as framework for sharing SBS information for enforcement-related purposes. In fact, prior to the adoption of the DFA, the SEC staff obtained SBS data from U.S. trade repositories pursuant to these MOUs on behalf of foreign regulators. The Commission staff will review our existing information sharing arrangements and discuss with our counterparts whether these arrangements fully cover the sharing of SBS data or whether amendments are necessary.

Q.9. In 2010, the Commission adopted rules designed to make money market funds more resilient and less likely to break the buck. Please discuss the Commission's experience with the implementation of the new rules and their impact on money market funds and the markets.

A.9. As you note, in 2010 the Commission adopted rules designed to increase the resiliency of money market funds. These reforms imposed new liquidity requirements on money market funds, reduced their exposure to interest rate and credit spread risk, and provided a means by which a money market fund that had broken the buck could cease redeeming shares and liquidate in an orderly manner. The rule changes also have provided the Commission with important data that Commission staff uses daily to monitor the operations of money market funds. Through this monitoring, there is some evidence that these reforms are working as intended and that money market funds have much greater levels of liquidity to meet potential redemptions. There also is some evidence that, as a result

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[6] Specifically, the Commission's authority to provide enforcement assistance to foreign authorities is contained in Section 21(a)(2) of the Exchange Act. Section 21(a) provides that:

On request from a foreign securities authority, the Commission may provide assistance in accordance with this paragraph if the requesting authority states that the requesting authority is conducting an investigation which it deems necessary to determine whether any person has violated, is violating, or is about to violate any laws or rules relating to securities matters that the requesting authority administers or enforces. The Commission may, in its discretion, conduct such investigation as the Commission deems necessary to collect information and evidence pertinent to the request for assistance. Such assistance may be provided without regard to whether the facts stated in the request would also constitute a violation of the laws of the United States. In deciding whether to provide such assistance, the Commission shall consider whether (A) the requesting authority has agreed to provide reciprocal assistance in securities matters to the Commission; and (B) compliance with the request would prejudice the public interest of the United States.

[7] A complete list of the SEC's cooperative arrangements in the areas of enforcement cooperation, supervisory cooperation and technical assistance can be found at: *http://www.sec.gov/about/offices/oia/oia_cooparrangements.htm.*

of these reforms, money market funds hold a greater amount of their portfolio in securities with a shorter maturity, which may have had an impact on the maturity structure of the short-term funding markets and increased rollover risk for entities relying on those markets for funding.

I note, however, that while these reforms to date have been successful at what they were intended to do, they specifically were not designed to address some of the structural features of money market funds that can make them susceptible to runs.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM MARY L. SCHAPIRO

Q.1.a. The agencies have submitted a proposed Volcker rule with over 1,300 questions, making it more of a concept release than a proposed rule. Additionally, the CFTC has not yet proposed its version of the Volcker Rule and might offer a competing version.

Given the complexity of the issues involved and that the CFTC has not signed on, do you anticipate extending the comment period?

A.1.a. The Commission and the Federal banking agencies extended the comment period for the Volcker proposal from January 13, 2012 to February 13, 2012. This extension gave commenters additional time to review, assess, and provide comments on the proposal.

Q.1.b. Do you anticipate doing a re-proposal?

A.1.b. We are reviewing the public comments that were submitted during the extended comment period before considering whether or not the Commission should re-propose a rule to implement the Volcker Rule.

Q.2.a. The agencies missed the October 18th statutory deadline for adopting a final Volcker rule, and despite agency delays, the rule is still scheduled to go into effect in July 2012. The Dodd-Frank Act had contemplated at least a 9-month timeframe of advance preparation for compliance.

Do you believe there will be sufficient time for banking entities to adjust to all of the changes imposed by the rule?

A.2.a. The joint Volcker Rule proposal requested comment on potential timeframes for compliance with the proposed rule. Some firms have indicated in meetings with Commission staff that the proposed effective date of July 21, 2012 will not provide sufficient time to establish a compliance program or to begin reporting quantitative measurements due to planned implementation of other new regulatory requirements and other systems issues. The Commission is considering this issue in light of comments received.

Q.2.b. Would it make sense to phase in the implementation of the rule, so as to identify potential market disruptions caused by any single element of the rule?

A.2.b. The joint Volcker Rule proposal asked for comment about a phased implementation of the proposed rule. We will continue to consider the option for such an implementation approach together with the other agencies involved.

Q.2.c. There is ample precedent for a phase-in, such as implementation of Regulation NMS. Do you believe the Volcker Rule calls for a similar phased-in approach?

A.2.c. The Commission has some experience with a phased implementation of a new rule, and, depending on the circumstances, it can be an effective approach to ease potential compliance and systems issues. The joint Volcker Rule proposal requested comment on a phased-in approach, and we look forward to considering comment on the issue.

RESPONSE TO WRITTEN QUESTION OF SENATOR SCHUMER FROM MARY L. SCHAPIRO

Q.1. The proposed regulatory framework under Section 619 of Dodd-Frank will certainly impact liquidity in the markets for many financial products to some degree. What analysis has been done to estimate the impact in various representative markets (*e.g.,* corporate bonds)? What are the main elements of the proposed rules which you believe mitigate potential harm to market liquidity? To the extent the proposed rules contain such mitigating elements, do you believe those safeguards are adequate?

A.1. The agencies requested extensive comment in the joint proposal about the potential economic impacts of the proposed implementation of Section 619 of the Dodd-Frank Act. We hope commenters will address these issues, particularly with respect to the proposed rule's potential impact on market liquidity, and that they will provide quantitative data, where possible.

The Commission staff is aware of a few public analyses that have been conducted to date. For example, Oliver Wyman conducted a study, commissioned by the Securities Industry and Financial Markets Association, on the potential impact of the proposed rule on liquidity in the corporate bond market. We posted this study in our public comment file and we will consider it in developing the final rule.

We believe the market making, underwriting, and hedging exceptions in the rule proposal should help mitigate any potential harm to market liquidity, while furthering the goals of the Volcker Rule. We are sensitive to issues involving market liquidity and will consider any comments discussing the proposed exception's potential impact on market liquidity in developing a final rule.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM MARY L. SCHAPIRO

Q.1. Last week the House Financial Services Committee passed unanimously a bill that exempts end users from margin requirements. Proposed margin rules ignore the clear intent of Congress that margin should not be imposed on end-user transactions. Do you all agree that end-user hedging does not meaningfully contribute to systemic risk, that the economy benefits from their risk management activity and that they should be exempt from margin requirements, and are you working together to provide consistent rules to provide end users with a clear exemption from margin requirements?

A.1. Federal margin requirements for securities were put into effect in response to the events of the Great Depression. They are designed to limit leverage in the system and protect dealers from uncollateralized exposure. This, in turn, protects the financial markets.

We recognize that certain types of entities active in the OTC derivatives markets traditionally have not posted margin and that these entities are concerned that regulatory margin requirements could interfere with their ability to hedge commercial risk. The other Federal agencies implementing the OTC derivatives rulemaking mandated by the Dodd-Frank Act have proposed requirements to address these concerns. Commission staff is consulting with these agencies and taking their approaches into consideration as it formulates a rule proposal for Commission consideration.

Q.2. Title VII of the Dodd-Frank Act states that the SEC and CFTC shall consult and coordinate to the extent possible for the purposes of assuring regulatory consistency and comparability. Will the SEC and CFTC propose the same rule on the extraterritorial application of Title VII?

A.2. Since the Dodd-Frank Act's passage, Commission staff has been engaged in ongoing discussions with CFTC staff regarding our respective approaches to implementing the statutory provisions of Title VII. In many cases, these discussions have led to a common approach.

However, the Dodd-Frank Act's application to security-based swaps may differ from its application to swaps, as the relevant products, entities and markets themselves are different. As a result, in certain instances, it may not be appropriate for the Commission's and the CFTC's rules to be identical, given the differences in the swap and security-based swap markets.

We will continue to coordinate with the CFTC to develop as harmonized an approach as practicable and appropriate as we work to develop proposed rules concerning the treatment of cross-border security-based swap transactions.

Q.3. Reviewing public comments and meeting with interested parties are good steps, but they are not a substitute for rigorous economic analysis that SEC Commissioners KathleenCasey and Troy Paredes called for and found lacking in the SEC staff study on Investment Advisers and Broker-Dealers. Before proposing any specific rule to public, is the SEC going to conduct and then make available for public comment rigorous economic analysis to inform its decisionmaking?

A.3. In considering any possible regulatory action in connection with the study on the investment advisers and broker-dealers required under Section 913 of the Dodd-Frank Act, the Commission expects to follow its usual practice of including its economic analysis for review and public comment as part of any rule proposal. This process has important benefits, as the comment process provides a mechanism for refining our economic analysis by seeking feedback on specific issues and making requests for private data. This is especially important where, as here, data necessary to conduct an analysis may not be publicly available. The process also provides us with additional insights from affected parties that may

not have been known or considered during the proposal's development. By analyzing and, where appropriate, incorporating this input into its analysis, the Commission is able to determine whether to proceed to a final rule and to produce the best possible final product.

In this case, it is likely to be especially important for the Commission to ask the public to provide additional relevant data or empirical analysis. As such, Commission staff, including its economists, is drafting a public request for information to obtain data specific to the provision of retail financial advice and the regulatory alternatives. It is our hope commenters will provide information that will allow Commission staff to continue to analyze the various components of the market for retail financial advice.

RESPONSE TO WRITTEN QUESTION OF SENATOR TOOMEY FROM MARY L. SCHAPIRO

Q.1. FSOC's proposed guidance will initially screen nonbanks for systemic relevance on the same $50bn threshold for banks.

How is this appropriate for the investment fund industry, where assets are managed not owned, and frequently in multiple funds none of which is $50bn but you have to add several funds together to get to the $50bn number?

A.1. FSOC's proposed guidance recognized that its proposed thresholds may not be appropriate for the investment fund industry. The release proposing this guidance states:

> The Council recognizes that the quantitative thresholds it has identified for application during Stage 1 may not provide an appropriate means to identify a subset of nonbank financial companies for further review in all cases across all financial industries and firms. While the Council will apply the Stage 1 thresholds to all types of nonbank financial companies, including financial guarantors, asset management companies, private equity firms, and hedge funds, these companies may pose risks that are not well-measured by the quantitative thresholds approach.
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> With respect to hedge funds and private equity firms in particular, the Council intends to apply the Stage 1 thresholds, but recognizes that less data is generally available about these companies than about certain other types of nonbank financial companies. Beginning in 2012, advisers to hedge funds and private equity firms and commodity pool operators and commodity trading advisors will be required to file Form PF with the Securities and Exchange Commission or the Commodity Futures Trading Commission, as applicable, on which form such companies will make certain financial disclosures. Using these and other data, the Council will consider whether to establish an additional set of metrics or thresholds tailored to evaluate hedge funds and private equity firms and their advisers.
>
> In addition, the Council, its member agencies, and the Office of Financial Research will analyze the extent to which there are potential threats to U.S. financial stability arising from asset management companies. This analysis will consider what threats exist, if any, and whether such threats can be mitigated by subjecting such companies to Board of Governors supervision and prudential standards, or whether they are better addressed through other regulatory measures. The Council may issue additional guidance for public comment regarding potential additional metrics and thresholds relevant to asset manager determinations.

I expect that the matters your question raises will be addressed as FSOC considers potential additional or different metrics or thresholds tailored to the investment fund industry.

RESPONSE TO WRITTEN QUESTIONS OF CHAIRMAN JOHNSON FROM GARY GENSLER

Q.1. Does your agency take economic impact analysis seriously in your rules? If so, please discuss if there are any barriers to better analysis, such as your agency's funding or ability to collect data from stakeholders who may be reluctant to share that information.

A.1. The CFTC does take economic impact analysis seriously. For example, the Commission strives to include well-developed considerations of costs and benefits in each of its proposed rulemakings. Relevant considerations are presented not only in the cost-benefit analysis section of the CFTC's rulemaking releases, but are discussed throughout the release in compliance with the Administrative Procedure Act, which requires the CFTC to set forth the legal, factual and policy basis for its rulemakings.

In its Dodd-Frank Act rules, each staff rulemaking team includes a member from the Commission's Office of the Chief Economist. Rulemakings involve quantified costs and benefits to the extent it is reasonably feasible and appropriate. For rules that do not have quantifiable costs, the Commission seeks to explain why such costs are not quantifiable and to explain the reasoning and supportive explanation of its predictive judgments using qualitative measures.

With each proposed rule, the Commission has sought public comment regarding costs and benefits. Nonetheless, at times commenters omit specific cost estimates.

Q.2. Even as you work to consult and harmonize the swap rules, it appears the SEC and CFTC do not plan to adopt a joint, integrated and coordinated approach to implementing the new rules. What can be done to ensure that your two agencies move together to issue an implementation plan for public comment that includes identical or coordinated dates for when the new rules go effective?

A.2. The CFTC and the SEC are coordinating closely in writing rules to implement the derivatives provisions of the Dodd-Frank Act. We have jointly proposed rulemakings and coordinated and consulted on each of the other rulemakings, including sharing many of our memos, term sheets and draft work product. This close working relationship has benefited the rulemaking process, and will continue throughout completion of rulemaking and implementation. On May 2 and May 3, 2011, SEC and CFTC staff jointly held roundtable discussions to get the public's views with regard to the very important issues associated with the implementation schedule for final rules. The Commissions gathered helpful information on a joint basis through this process as well as through subsequent analysis of written submissions. The Commissions have collected valuable information to guide efforts in a manner that facilitates efficient and coordinated implementation.

Q.3. The sharing of swap data among international and domestic regulators is critical to reducing systemic risk in the global derivatives market. Could you describe how the CFTC plans to further the goal of allowing U.S. and international regulators the ability to share swap data, and the types of international swap data sharing arrangements the United States plans to enter into with other financial regulatory authorities? Also, how will these international swap data sharing arrangements address the indemnification pro-

visions contained in Title VII of the Wall Street Reform Act, and do you anticipate any challenges in implementing effective data sharing arrangements with international regulators resulting from such indemnification provisions that cannot be addressed through CFTC "exemptive authority," powers granted under Section 752 of the Wall Street Reform Act, or other authorities provided to your agency?

A.3. The CFTC is working to ensure that both domestic and international regulators have access to swap data to support their regulatory mandates. The Commission was an active participant in the 2010 Financial Stability Board report, which highlighted the fact that trade repository data will allow authorities to address vulnerabilities in the financial system and to develop well-informed regulatory, supervisory and other policies that promote financial stability and reduce systemic risks.

The Commission specifically addressed access to swap data repository (SDR) data in its final SDR rulemaking. In that rulemaking, the CFTC noted that the Dodd-Frank Act requires a registered SDR to make available on a confidential basis all data obtained by the registered SDR to "appropriate domestic regulators" and "appropriate foreign regulators."

With respect to indemnification, in its SDR rulemaking, the CFTC notes that we are "mindful that the Confidentiality and Indemnification Agreement requirement . . . may be difficult for certain domestic and foreign regulators to execute with an SDR due to various home country laws and regulations." Accordingly, the Commission rule allows for the provision of access to swap data reported and maintained by SDRs for domestic regulators without being subject to the notice and indemnification provisions of the Commodity Exchange Act (CEA) if the SDR is subject to the regulatory jurisdiction of, and registers with, the domestic regulator. In addition, pursuant to a separate provision of the CEA, the SDR may be permitted to provide direct electronic access to such regulator as a designee of the Commission.

With respect to foreign regulatory authorities, the rule provides that data in an SDR may be accessed by an appropriate foreign regulator without the execution of a confidentiality and indemnification agreement in appropriate circumstances. Such access may be granted when the regulator is acting with respect to a SDR that is also registered with that regulator or when the foreign regulator, pursuant to section 8(e) of the CEA, receives SDR information from the Commission.

The Commission continues to review the indemnification provisions of the CEA. CFTC staff is actively discussing with foreign regulators how to implement effective information sharing arrangements with non-U.S. regulators, and I anticipate that staff will make additional recommendations for the Commission's consideration to facilitate regulators' access to information necessary for regulatory, supervisory and enforcement purposes.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM GARY GENSLER

Q.1. As you noted in your testimony, access by regulators to data about the swaps market is important. The Depository Trust & Clearing Corporation operates a regulators' portal to give regulators access to certain OTC derivatives data.

- Does the CFTC have access to and review this information?
- If so, when did the CFTC begin accessing and reviewing this information? If not, why not?

A.1. Commission staff expect that the Depository Trust & Clearing Corporation (DTCC) will seek registration as a Swap Data Repository (SDR). Commission staff make themselves available to all such applicants to consult on practical and technical issues, including in the case of SDRs how the CFTC will use technology to access SDR data. With regard to the DTCC regulators' portal, Commission staff is working with the DTCC in order to obtain access.

Q.2. The agencies have submitted a proposed Volcker rule with over 1,300 questions, making it more of a concept release than a proposed rule. Additionally, the CFTC has not yet proposed its version of the Volcker Rule and might offer a competing version.

- Given the complexity of the issues involved and that the CFTC has not signed on, do you anticipate extending the comment period?
- Do you anticipate doing a re-proposal?

A.2. The CFTC's proposed rule was published in the Federal Register on February 14, 2012. The Commission looks forward to receiving public comments and will carefully consider those comments before determining how to proceed further.

Q.3. The agencies missed the October 18th statutory deadline for adopting a final Volcker rule, and despite agency delays, the rule is still scheduled to go into effect in July 2012. The Dodd-Frank Act had contemplated at least a 9-month timeframe of advance preparation for compliance.

- Do you believe there will be sufficient time for banking entities to adjust to all of the changes imposed by the rule?
- Would it make sense to phase in the implementation of the rule, so as to identify potential market disruptions caused by any single element of the rule?
- There is ample precedent for a phase-in, such as implementation of Regulation NMS. Do you believe the Volcker Rule calls for a similar phased-in approach?

A.3. The CFTC's release of its proposed rulemaking specifically asks commenters to provide information regarding time needed to comply and proper phasing of implementation. The Commission will carefully take into account all public comments.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM GARY GENSLER

Q.1. Last week the House Financial Services Committee passed unanimously a bill that exempts end users from margin require-

ments. Proposed margin rules ignore the clear intent of Congress that margin should not be imposed on end-user transactions. Do you all agree that end-user hedging does not meaningfully contribute to systemic risk, that the economy benefits from their risk management activity and that they should be exempt from margin requirements, and are you working together to provide consistent rules to provide end users with a clear exemption from margin requirements?

A.1. In the Dodd-Frank Act, Congress recognized the different levels of risk posed by transactions between financial entities and those that involve nonfinancial entities, as reflected in the nonfinancial, end-user exception to clearing. The risk of a crisis spreading throughout the financial system is greater the more interconnected financial companies are to each other. Interconnectedness among financial entities allows one entity's failure to cause uncertainty and possible runs on the funding of other financial entities, which can spread risk and economic harm throughout the economy. Consistent with this, the CFTC's proposed rules on margin requirements focus only on transactions between financial entities and exclude end users.

Q.2. While the CFTC proposal may not require margin to be posted for uncleared swaps involving some commercial end users, the test for qualifying as an end user is based upon a distinction between financial entities and nonfinancial entities and any swap dealer is considered a financial entity. Therefore, the issue becomes how the CFTC defines swap dealers and whether many end users may be captured as swap dealers and subject to posting margin. Can you explain how many swap dealers you are expecting to require to register and what types of entities may be captured by this term?

A.2. The Dodd-Frank Act includes a definition of the term "swap dealer" and also requires the CFTC and SEC to jointly adopt rules further defining the term. The number of entities required to register is uncertain and will depend on the decisions of businesses involved. In an effort to estimate how many entities may register as swap dealers, CFTC staff analyzed the membership statements of relevant trade associations that list swap dealers as members and other relevant sources. CFTC staff estimates that 100–150 entities may seek to register with the Commission as swap dealers.

Q.3. Title VII of the Dodd-Frank Act states that the SEC and CFTC shall consult and coordinate to the extent possible for the purposes of assuring regulatory consistency and comparability. Will the SEC and CFTC propose the same rule on the extraterritorial application of Title VII?

A.3. The CFTC and the SEC coordinate very closely with regard to all aspects of rulemaking under Title VII of the Dodd-Frank Act. The two agencies will continue to do so as the rulemaking process proceeds including, with regard to extraterritorial application.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM GARY GENSLER

Q.1. Dodd-Frank created the FSOC as a way to make sure all of the regulatory agencies are communicating and rules across the

agencies can be as consistent as possible. However, we have seen recently with the release of the Volcker rule by the FDIC, Federal Reserve, OCC and SEC that even with the FSOC and a law that mandates coordination, not all of the agencies can work together.

Despite the new construct, the CFTC is now working on its own rule and has not signed onto the existing rule with the rest of you. Have you all contemplated how it might work to have an individual who handles multiple product lines being forced to adhere to the two different standards? Couldn't that be problematic functionally? Also, do you believe, since the CFTC is going to develop its own rule, we should extend the timeline for implementation so that the interested parties can view ALL of the regulators' proposals and how they will interconnect before filing official comments?

A.1. The CFTC's proposed rule was published in the Federal Register on February 14, 2012. The Commission looks forward to receiving public comments and will carefully consider those comments before determining how to proceed further. The Commission will continue to coordinate closely with fellow regulators regarding implementation of all Dodd-Frank Act provisions.

Q.2. The SEC and CFTC recently approved the final version of Form PF, the new systemic risk reporting form for SEC-registered managers to private funds. In addition to Form PF, the CFTC has proposed its own separate systemic risk reporting forms (Forms CPO–PQR and CTA–PR) for firms registered with the CFTC. The final Form PF release indicates that managers that are registered with both the SEC and CFTC may have the option to consolidate their information on Form PF, rather than reporting on separate forms, if the CFTC determines to makes changes to its proposed forms.

The CFTC has not yet published final versions of its proposed forms. Does the CFTC intend to allow firms to reduce their compliance burden by submitting systemic risk information on a single form?

A.2. Entities that are dual registrants may file Form PF for all operated pools without having to file Form CPO–PQR on a quarterly basis. Such firms will continue to have to file demographic information on Schedule A of Form CP–PQR on an annual basis.

Q.3. The final Form PF release indicates that the SEC and CFTC will adopt policies and procedures to ensure strong confidentiality protections for information submitted on Form PF. Does the CFTC intend to adopt similar confidentiality safeguards for information submitted on Forms CPO–PQR and CTA–PR? As you know, the recent public disclosure of confidential trading information that was provided to the CFTC in 2008 was very troubling to market participants.

A.3. The CFTC received considerable comment regarding confidential treatment of information submitted by registrants. In response, the final rule adopted by the Commission designates certain information in Forms CPO–PQR and CTA–PR as confidential.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM MARTIN J. GRUENBERG

Q.1. Chairman Gruenberg, in your testimony you discuss the FDIC's implementation of Title II of the Dodd-Frank Act and how the FDIC is preparing to resolve, if necessary, systemically significant institutions with its new orderly liquidation authority.

Had MF Global been deemed systemically significant before its collapse, would the FDIC have been able to resolve MIT Global under Title II?

A.1. Yes, the FDIC could have resolved MF Global had it been necessary. The FDIC has the legal authority, technical expertise, and operational capability to resolve a systemically significant financial institution with its new orderly liquidation authority. Since the Dodd-Frank Act was enacted on July 21, 2010, the FDIC has established a new Office of Complex Financial Institutions. This new office is monitoring risk, conducting resolution planning, and coordinating with regulators overseas. We also have completed a series of rulemakings that implement our orderly liquidation authority under Title II of the Dodd-Frank Act and have finalized the joint rulemaking with the Federal Reserve Board to implement the resolution requirements ("living wills").

Q.2. The agencies have submitted a proposed Volcker rule with over 1,300 questions, making it more of a concept release than a proposed rule. Additionally, the CFTC has not yet proposed its version of the Volcker Rule and might offer a competing version.

- Given the complexity of the issues involved and that the CFTC has not signed on, do you anticipate extending the comment period?
- Do you anticipate doing a re-proposal?

A.2. On January 3, 2012, the agencies announced a 30-day extension of the comment period to February 13, 2012. On January 11, 2012, the CFTC approved its notice of proposed rulemaking to implement the Volcker Rule, with substantially identical proposed rule text as in the interagency notice of proposed rulemaking. The comment period extension was intended to facilitate public comment on the provisions of the rule and the questions posed by the agencies, as well as coordination of the rulemaking among the responsible agencies. The agencies will carefully consider the comments received on the proposed Volcker Rule in the development of the final rule and, as part of this review, will consider whether a re-proposal is necessary.

Q.3. The agencies missed the October 18th statutory deadline for adopting a final Volcker rule, and despite agency delays, the rule is still scheduled to go into effect in July 2012. The Dodd-Frank Act had contemplated at least a 9-month timeframe of advance preparation for compliance.

- Do you believe there will be sufficient time for banking entities to adjust to all of the changes imposed by the rule?
- Would it make sense to phase in the implementation of the rule, so as to identify potential market disruptions caused by any single element of the rule?

- There is ample precedent for a phase-in, such as implementation of Regulation NMS. Do you believe the Volcker Rule calls for a similar phased in approach?

A.3. The FDIC and the other agencies recognize the complexities associated with Section 619 of the Dodd-Frank Act and the care and attention required for implementing and complying with the new rules. Perhaps because of these complexities, the statute specifically provides affected companies with a minimum of 2 years to come into compliance with Section 619, which can be extended by rule or order by the Federal Reserve Board. Further, it is our understanding that many of the institutions affected by these proposed rules have begun preparing for their promulgation. However, although alternative approaches are not explicitly under consideration, the agencies continuously gauge the reasonableness of the implementation of rules and their impact on stakeholders.

RESPONSE TO WRITTEN QUESTION OF SENATOR CRAPO FROM MARTIN J. GRUENBERG

Q.1. Last week the House Financial Services Committee passed unanimously a bill that exempts end users from margin requirements. Proposed margin rules ignore the clear intent of Congress that margin should not be imposed on end-user transactions.

Do you all agree that end-user hedging does not meaningfully contribute to systemic risk, that the economy benefits from their risk management activity and that they should be exempt from margin requirements, and are you working together to provide consistent rules to provide end users with a clear exemption from margin requirements?

A.1. Nonfinancial end users appear to pose minimal risks to the safety and soundness of swap dealers and to U.S. financial stability when they hedge commercial risks with derivatives and the related unsecured exposure remains below an appropriate credit exposure threshold. Accordingly, the proposed rule does not specify a minimum margin requirement for transactions with nonfinancial end users. Rather, the proposed rule, consistent with long-standing supervisory guidance, would permit a swap dealer to adopt, where appropriate, its own thresholds below which the swap dealer is not required to collect margin from counterparties that are nonfinancial end users. In addition, low-risk financial end users, including most community banks, would not be required to post collateral for initial margin unless their activity exceeds either substantial thresholds or the risk limits set by the swap dealer with which they are doing business. Such thresholds are usually explicitly set forth in a credit support agreement or other agreement and are approved and monitored by the swap dealer as part of its own credit approval process.

As noted in the proposal, this approach is consistent with current market practices with respect to nonfinancial end users and low risk financial end users, in which swap dealers view the question of whether, and to what extent, to require margin from their counterparties as a part of the prudent credit decision process and consistent with safe and sound banking practices. Accordingly, the prudential regulators would expect that the direct costs and bene-

fits of hedging with noncleared derivatives by nonfinancial end users and low risk financial end users, including with respect to opportunity costs and earnings volatility, would remain unchanged relative to current market practices under the terms of the proposed rule.

In issuing the proposal, the prudential regulators requested comment on a variety of issues related to the effect of the proposed margin requirements on nonfinancial end users, including whether alternative approaches—such as an exemption similar to the mandatory clearing exemption—are preferable. We have received a variety of comments from members of the public, including commercial firms that use swaps to hedge their risk. The prudential regulators will carefully consider all comments as we evaluate the proposal in light of comments received and formulate a final rule.

RESPONSE TO WRITTEN QUESTION OF SENATOR TOOMEY FROM MARTIN J. GRUENBERG

Q.1. As written, the proposed interagency rule to implement the so-called "Volcker Rule" would impose new and very substantial and costly compliance burdens on many banks that do not have a standalone proprietary trading desk or substantial fund investments, and never have. Specifically, the proposed rule would require these institutions to establish, at a minimum, policies and procedures designed to prevent the occurrence of activities in which the institution is not engaged—in other words, the regulatory equivalent of proving a negative. It sounds to me like that could be a very costly undertaking for an institution that was never the intended target of the Volcker Rule. But more importantly, this makes even less sense given the economic challenges we face and the need to direct resources toward capital planning and lending.

Can you comment on why this is necessary? Is there a less onerous way to implement the permitted activities?

A.1. We agree that banking organizations that are not engaged in activities or investments prohibited by the Volcker Rule should not face an onerous compliance burden. In fact, the proposed regulations specifically provide that such a banking organization will have been deemed to satisfy compliance requirements if its existing compliance policies and procedures include provisions designed to prevent the institution from becoming engaged in statutorily prohibited activities or making statutorily restricted investments. Further, for those banks that do engage in trading activities covered by the statute, the regulations provide an asset size threshold for the reporting and record keeping requirements, which provide smaller institutions with significantly less burdensome requirements. We recognize the importance of this issue and will carefully consider comments concerning implementation burden.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM JOHN WALSH

Q.1. Comptroller Walsh, in your testimony you discuss the Dodd-Frank requirement that the Bureau of Consumer Financial Protection and prudential regulators coordinate their supervision activi-

ties in order to effectively regulate banks. You note that the Bureau must consult with prudential regulators and that the Bureau and prudential regulators are required to conduct examinations simultaneously. You state, however, "Candidly, aspects of this portion of the Dodd-Frank Act do not mesh well with how bank examination activities are actually conducted."

Would you please elaborate on this statement?

A.1. Section 1025 of the Dodd-Frank Act requires the prudential regulators and the CFPB to coordinate their examination and supervision of insured depository institutions and their affiliates with assets of more than $10 billion in a number of ways. First, section 1025 requires the prudential regulators and the CFPB to coordinate their examinations of such institutions and conduct simultaneous examinations unless an institution requests the examinations to be conducted separately. In addition, the prudential regulators and the CFPB must share draft reports of examination and the receiving agency must be provided at least 30 days to comment on the draft report before it is made final. Moreover, an agency must take into consideration any comments received from the other agency before issuing a final report of examination or taking supervisory action.

We support the goal reflected in section 1025 of minimizing unnecessary regulatory burden in connection with the supervisory activities of the CFPB and the prudential regulators. However, as drafted, the requirements of section 1025 do not mesh well with the practicalities and scope of prudential regulators' actual examination responsibilities and practices. First, the universe of institutions with over $10 billion in assets are examined in different ways—some are subject to continuous supervision by resident exam teams, others are subject to more discrete point-in-time exams. These differences present challenges in coordinating "simultaneous" examinations. The scope of the prudential regulators' examinations also is much broader than the examination authority of the CFPB such that "simultaneous" examination activity could have little relevance to the apparent statutory objective unless the examination activity is related to the same activity, product or service at an institution.

The banking agencies and the CFPB are currently discussing a potential Memorandum of Understanding that would better synchronize exam activities in such related areas.

Q.2.a. The agencies have submitted a proposed Volcker rule with over 1,300 questions, making it more of a concept release than a proposed rule. Additionally, the CFTC has not yet proposed its version of the Volcker Rule and might offer a competing version.

Given the complexity of the issues involved and that the CFTC has not signed on, do you anticipate extending the comment period?

A.2.a. Due to the complexity of the issues involved and to facilitate coordination of the rulemaking among the responsible agencies as provided in section 619 of the Dodd-Frank Act, the OCC, Board, FDIC and SEC (the agencies) extended the comment period on the joint notice of proposed rulemaking implementing section 619 (the Proposal) from January 13, 2012 until February 13, 2012. The no-

tice of extension of comment period was published in the *Federal Register* on January 3, 2012. *See* 77 Fed. Reg. 23.

Q.2.b. Do you anticipate doing a re-proposal?

A.2.b. The agencies will consider this question after they have had an opportunity to review all comments submitted on the Proposal and have evaluated the extent of changes that they envision making to the Proposal.

Q.2.c. The agencies missed the October 18th statutory deadline for adopting a formal Volcker rule, and despite agency delays, the rule is still scheduled to go into effect in July 2012. The Dodd-Frank Act had contemplated at least a 9-month timeframe of advance preparation for compliance. Do you believe there will be sufficient time for banking entities to adjust to all of the changes imposed by the rule?

A.2.c. Much of the timing for compliance with the final Volcker regulation is dictated by section 619 of the Dodd-Frank Act. Section 619 goes into effect on July 21, 2012 (even without final rules), and provides a 2-year conformance period that runs until July 2014. Banking entities may use this conformance period to bring their existing activities, investments, and relationships into compliance with section 619. In addition, section 619 provides that banking entities may request up to three 1-year extensions of this conformance period from the Federal Reserve Board and another 5-year extension from the Board to divest of certain illiquid funds.

On February 8, 2011, the Board issued a Conformance Rule implementing the conformance provisions of section 619. However, the Conformance Rule was re-issued on November 7, 2011, together with the Proposal issued by the agencies, and the Board is soliciting comment on whether any portion of the Conformance Rule should be revised in light of other elements of the Proposal.

We also recognize that the Proposal (including its compliance program requirements and recordkeeping and reporting requirements), if adopted as published for comment, would become effective on July 21, 2012. Recognizing the potential issues this presents, the Proposal specifically solicits comment on whether this effective date will provide banking entities with sufficient time to comply with the prohibitions and restrictions on proprietary trading and covered fund activities and implement the proposed compliance program and reporting and recordkeeping requirements. The agencies plan to consider carefully any comments received on this issue.

Q.2.d. Would it make sense to phase in the implementation of the rule, so as to identify potential market disruptions caused by any single element of the rule?

A.2.d. The Proposal expressly requests comment on whether the agencies should use a gradual, phased-in approach to implement the statute rather than having the implementing rules become effective at one time and asks banking entities to identify prohibitions andrestrictions that should be implemented first, if the agencies choose to implement a phased-in approach. We plan to consider carefully any comments received on this issue.

Q.2.e. There is ample precedent for a phase-in, such as implementation of Regulation NMS. Do you believe the Volcker Rule calls for a similar phased-in approach?

A.2.e. The Proposal solicits comment on this issue and the agencies plan to carefully consider any comments received on the merits of a phased-in approach.

RESPONSE TO WRITTEN QUESTION OF SENATOR CRAPO FROM JOHN WALSH

Q.1. Last week the House Financial Services Committee passed unanimously a bill that exempts end users from margin requirements. Proposed margin rules ignore the clear intent of Congress that margin should not be imposed on end-user transactions. Do you all agree that end-user hedging does not meaningfully contribute to systemic risk, that the economy benefits from their risk management activity and that they should be exempt from margin requirements, and are you working together to provide consistent rules to provide end users with a clear exemption from margin requirements?

A.1. We agree that end-user hedging does not meaningfully contribute to systemic risk, and that the economy benefits from risk management activity. As the agencies stated as part of the rule proposal, nonfinancial end user hedging typically poses minimal risk to U.S. financial stability, particularly in the case of small margin exposures. (76 Federal Register 27564, 27570 (May 11, 2011).

However, swaps with a commercial end user do expose the dealer to credit risk, similar to an unsecured line of credit. The banking agencies have long required dealers to prudently manage this credit risk, in combination with their credit risk management measures for other credit exposures to the same end user. Banks have legal lending limits to ensure that they do not have potentially dangerous concentrations of risk with a single counterparty. Derivatives exposures are simply another use of those limits. While end-user activity has not historically contributed meaningfully to systemic risk, it has led to credit losses. Banks report charge-offs of derivatives exposures nearly every quarter. They are typically related to swaps with commercial borrowers, who indeed have used swaps as a hedge. Hedging by commercial end users does not necessarily translate into lower counterparty risk, nor for that matter does it insulate a business from poor operating or investment decisions that can lead to failure.

The proposed margin requirements were designed to incorporate this existing safety and soundness practice, to prevent unusually large credit exposure to a commercial end user in the form of swaps from going unmanaged, by requiring margin when the dealer's credit exposurefrom swaps exceed the bank's internal credit limit for the counterparty.

We received a number of comments, both from the industry and commercial counterparties, expressing concern about this aspect of the proposal. We did not intend our proposal to signal a change from current practices in this regard. Credit exposure from swaps with a commercial counterparty is typically a relatively small part

of the overall credit relationship to the firm, and banks rely on their credit risk management process to keep the complete exposure within the internal credit limit. As we proceed with developing a final rule, we will be careful to take the views of these commenters into account.

RESPONSE TO WRITTEN QUESTION OF SENATOR TOOMEY FROM JOHN WALSH

Q.1. Could you please explain the effect on banks, especially community banks, if the SEC's municipal adviser proposal is finalized as written? For example, there will clearly be duplicative examinations and regulations. Do you think there is need for this duplication, or are there areas that the SEC would review that bank regulators do not? What do you think the costs and potential consequences of such duplicative examination would be?

A.1. As proposed, the SEC's municipal advisor rules apply not only to previously unregulated activities, but also to banks that provide traditional banking products and services to municipalities. Banks would be subject to ongoing supervision, examination, and enforcement by the SEC simply by providing municipalities with advice on traditional banking activities such as deposit accounts, savings accounts, certificates of deposit, bank loans and letters of credit, and trust and fiduciary services. Banks are already subject to ongoing supervision, examination, and enforcement by the OCC and other Federal banking regulators for these same activities. Duplicative regulation and supervision of traditional banking activities is unnecessary and may be especially burdensome on smaller, community institutions. These concerns were included in the attached comment letter from John Walsh, Acting Comptroller of the Currency, dated May 24, 2011, on the SEC's Proposed Regulation of Municipal Advisors, File No. S7–45–10.

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

May 24, 2011

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Proposed Regulation of Municipal Advisors, File No. S7-45-10

Dear Ms. Murphy:

I am writing to convey the comments of the Office of the Comptroller of the Currency ("OCC") on rules that the Securities and Exchange Commission (the "Commission" or "SEC") has proposed to implement the municipal advisor registration requirement mandated by Section 975 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Section 975").[1] Section 975 defines the term "municipal advisor" and establishes municipal advisors as a new category of SEC registrant. The Proposed Rules broaden the definition of municipal advisor, define additional terms, provide exclusions, and establish the related registration requirements.

The Commission specifically requested comments on whether to "exclude from the definition of a 'municipal advisor' banks providing advice to a municipal entity or obligated person" with respect to certain traditional banking products and services, including deposit transactions and trust and fiduciary services.[2] Section 975 was designed to strengthen oversight of the municipal securities market by extending registration requirements to previously unregulated transactions.[3] In contrast, traditional banking products and services, such as commercial deposit-taking and trust and fiduciary services, already are subject to extensive supervision and regulation. In our view, imposing the additional registration, examination, and other requirements as set forth in the Proposed Rules to those services is unnecessary and duplicative. We therefore strongly support the type of exclusion from the definition of "municipal advisor" upon which the Commission sought comment.

[1] Registration of Municipal Advisors, SEC Release No. 34-63576, 76 Fed. Reg. 824 (Jan. 6, 2011) ("Proposed Rules").

[2] 76 Fed. Reg. at 837.

[3] S. Rep. No. 111-176, at 147 (2010).

Attached are OCC staff comments that describe our concerns in more detail. The OCC appreciates the opportunity to comment on this proposal, and would welcome the opportunity to discuss any questions regarding these comments, as appropriate. OCC points of contact are Ellen Broadman, Director, Securities and Corporate Practices (202-874-5210) and Judy Foster, Risk Specialist, Credit and Market Risk (202-874-7450).

Sincerely,

John Walsh
Acting Comptroller of the Currency

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

OCC STAFF COMMENTS RE: SEC PROPOSAL TO IMPLEMENT MUNICIPAL ADVISOR REGISTRATION REQUIREMENTS

Background

Section 975 amended the Securities and Exchange Act of 1934[4] ("Exchange Act") to add "municipal advisors" as a new category of regulated persons to the existing regulatory scheme for municipal securities brokers and dealers. A municipal advisor is subject to a comprehensive regulatory framework developed by the Securities and Exchange Commission (SEC) and the Municipal Securities Rulemaking Board (MSRB). The SEC has proposed rules implementing Section 975.[5] In addition, Section 975 directs the MSRB to issue rules providing for, among other things, continuing education requirements and professional standards specific to municipal advisors.[6]

The statute defines a municipal advisor as someone who "provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities…"[7] The statute limits municipal financial products to "municipal derivatives, guaranteed investment contracts, and investment strategies." The statute also clarifies that investment strategies are "plans or programs for the investment of the proceeds of municipal securities that are not municipal derivatives, guaranteed investment contracts, and the recommendation of and brokerage of municipal escrow investments."[8] In the Proposed Rules, the Commission expands the meaning of "investment strategies" to include "plans, programs, or pools of assets that invest funds held by or on behalf of a municipal entity," and requires that

[4] 15 U.S.C. § 78a et seq.

[5] Registration of Municipal Advisors, SEC Release No. 34-63576, 76 Fed. Reg. 824 (Jan. 6, 2011) ("Proposed Rules").

[6] *See* MSRB Notice 2010-47 (Nov. 1, 2010). Recently the MSRB has requested comments on several rules that would apply to municipal advisors, including: Rule G-17 (applying fair dealing rule to municipal advisors); Rule G-20 (gifts and gratuities); Rule G-36 (fiduciary duty rule); and a draft proposal prohibiting "pay to play" activities. The MSRB has not yet issued proposals on the qualifications, training, and certification requirements for municipal advisors.

[7] 15 U.S.C. § 78o-4(e)(4).

[8] 15 U.S.C. § 78o-4(e)(5) and 15 U.S.C. § 78o-4(e)(3).

persons advising municipal entities on investment strategies and other financial products register as "municipal advisors."[9]

It appears that various traditional banking products and services provided to municipal clients would satisfy the SEC's proposed definition of "investment strategies." As a result, banks would become municipal advisors simply by providing these traditional products and services. While the Proposed Rules include certain exemptions, the proposed framework does not exempt from registration banks that offer traditional banking products and services to municipal entities, including deposit products, and trust and fiduciary services.

For decades, banks have provided traditional banking products and services to municipal entities and obligated persons[10] as an integral part of their commercial, trust, and fiduciary businesses. Traditional banking products and services are critical financial management tools, especially for smaller municipalities whose financing needs cannot be addressed through public offerings of municipal securities. In particular, as an alternative to public financing, a municipal entity may prefer to obtain funding through a bank loan, which is typically less expensive and more readily available in smaller sums. Municipal entities may also opt to minimize their liquidity risks and investment concerns by utilizing the bank's cash management services for deposit accounts.

Banks' deposit accounts, loan transactions, trust and fiduciary services, and other traditional products and services already are subject to an extensive and comprehensive regulatory framework and supervision by the federal banking agencies. The OCC monitors, assesses, regulates, and enforces compliance with federal regulations, guidance, and policies regarding all bank activities, including deposit accounts, trust services, and other traditional banking products and services provided to all bank customers.[11] In addition, the OCC evaluates banks to ensure the products and services offered do not expose the institution to litigation, financial loss, or reputation risk.[12] Thorough on-site examinations occur on a regular basis, and at large banks, the OCC has examiners on-site full-time. Banks must develop internal recordkeeping and auditing systems to track transactions with all bank customers, including municipal entities, which facilitates an effective examination process and ensures banks are themselves monitoring the

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[9] 76 Fed. Reg. at 830. However, it is unclear which types of communications would be considered "advice" because neither Section 975 nor the Proposed Rules define the term.

[10] "Obligated person" means "any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account of such person, committed by contract or other arrangement to support the payment of all or part of the obligations on the municipal securities to be sold in an offering of municipal securities." 15 U.S.C. § 78o-4(e)(10). The SEC also clarified that obligated persons can include entities acting as conduit borrowers such as private universities, non-profit hospitals, and private corporations. 76 Fed. Reg. at 829 n.86.

[11] *See, e.g.*, Comptroller's Handbook, *Bank Supervision Process* (2007); Comptroller's Handbook, *Asset Management* (2000); Comptroller's Handbook, *Large Bank Supervision* (2010); Comptroller's Handbook, *Community Bank Supervision* (2010).

[12] *See, e.g.*, Comptroller's Handbook, *Bank Supervision Process* (2007) (describing the evaluation of a bank's reputational risk).

activities as well.[13] The OCC evaluates the effectiveness of the recordkeeping systems during the extensive on-site examinations.[14] The OCC also analyzes bank management to ensure the leadership at each bank has the training and experience necessary to provide the products and services offered by that bank.[15]

Traditional banking products and services are critical to the day-to-day financial operations of a municipal entity. Given the extensive and well-established regulatory and supervisory framework governing traditional banking products and services, discussed in more detail below, the municipal advisor framework in the Proposed Rules would be unnecessary and duplicative. At a minimum, the Commission should clarify that banks providing municipal entity customers advice regarding traditional banking products including deposit accounts, savings accounts, certificates of deposit, bankers acceptances, bank loans and letters of credit, and certain loan participations do not need to register as municipal advisors.[16]

Neither the statute nor the corresponding legislative history indicate that Congress intended that the registration requirements in Section 975 be triggered by providing traditional banking products and services to municipal entities. Rather, Congress sought to target previously unregulated market participants and financial transactions, not participants in already highly-regulated banking activities.[17] In particular, Congress identified financial advisors, certain third party solicitors, and individuals marketing complex financial instruments such as guaranteed investment contracts, swaps, and other municipal derivatives as the intended group of municipal advisors.[18] Notably absent from this list is any reference to retail bankers or the traditional banking products and services they provide.

Treatment of Municipal Deposits, Letters of Credit, and Liquidity Facilities

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[13] *See, e.g.*, 12 C.F.R. § 9.8 (retention of records for all fiduciary accounts); 12 C.F.R. § 12.3 (securities recordkeeping requirements); 12 C.F.R. § 204.3 (requiring filing of a report of deposits); 12 C.F.R. § 205.13 (retention of records related to electronic funds transfers).

[14] *See* Comptroller's Handbook, *Internal Controls* (2001) (describing the components of an effective control system and the procedures to examine and assess the controls).

[15] *See* Comptroller's Handbook, *Bank Supervision Process* (2007) (detailing the CAMELS rating system and standards for evaluating bank management).

[16] 15 U.S.C. § 78c note (defining "identified banking product" to include: deposit account, savings account, certificate of deposit, or other deposit instrument issued by a bank; a banker's acceptance; a letter of credit issued or loan made by a bank; a participation in a loan which the bank or an affiliate of the bank (other than a broker or dealer) funds, participates in, or owns that is sold to certain individuals).

[17] S. Rep. No. 111-176, at 147 ("Section 975 strengthens oversight of municipal securities and broadens current municipal securities market protections to cover previously unregulated market participants and previously unregulated financial transactions with states, counties, cities and other municipal entities.").

[18] S. Rep. No. 111-176, at 149.

The Proposed Rules require a person giving advice with regard to "plans, programs, or pools of assets that invest funds held by or on behalf of a municipal entity" to register as a municipal advisor unless covered by an exclusion.[19] This definition appears broad enough to cover deposits of municipal funds in commercial, checking, savings, time, and trust accounts at insured depository institutions. As a result of this broad definition, banks simply offering a deposit account[20] to a municipal entity would be subject to the Proposed Rules' recordkeeping requirements for municipal advisors.[21] These banks may also be subject to future professional qualification standards and continuing education requirements that have not yet been established.[22]

As noted above, the OCC and the other federal banking agencies have an existing regulatory framework and oversight over traditional banking products and services, which include bank deposit transactions.[23] The federal regulatory framework includes stringent recordkeeping requirements that are specific to deposit accounts at banking institutions.[24] Subjecting banks to recordkeeping requirements that are intended for advisors in the municipal securities market is unnecessary and duplicative.

The OCC also already evaluates the ability of bank management to monitor and control traditional banking products and services, including the administration of deposit accounts, through regular and extensive on-site examinations.[25] Subjecting banks and their employees to the training requirements associated with the municipal advisors regulatory framework, including any future municipal advisor certification and testing program, as a result of a bank

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[19] 76 Fed. Reg. at 830 ("...because every bank account of a municipal entity is comprised of funds 'held by or on behalf of a municipal entity,' money managers providing advice to municipal entities with respect to their bank accounts could be municipal advisors.").

[20] 12 U.S.C. § 1813(l) (defining deposit).

[21] Proposed Rule 15Ba1-7 (outlining the books and records that must be made and maintained by municipal advisors).

[22] 15 U.S.C. § 78o-4(c)(7); MSRB Notice 2010-47 (Application of MSRB Rules to Municipal Advisors) (Nov. 1, 2010).

[23] *See, e.g.*, 12 U.S.C. § 24(Seventh) (authorizing national banks to receive demand deposits, Negotiable Order of Withdraw accounts, time deposits, brokered deposits, and special deposits); 12 U.S.C. § 90 (deposits of public funds); 12 C.F.R. Part 5 (providing rules, policies, and procedures for corporate activities); 12 C.F.R. § 7.4002 (regulating national bank charges on deposit accounts); 12 C.F.R. Part 30 (safety and soundness standards); 12 C.F.R. Part 205 (direct deposits and withdrawals of funds); 12 C.F.R. Part 217 (interest on demand deposits); 12 C.F.R. Part 229 (Regulation CC – Availability of Funds and Collection of Checks); and 12 C.F.R. Part 230 (Regulation DD - Truth in Savings).

[24] *See, e.g.*, 12 C.F.R. § 204.3 (filing of report of deposits); 12 C.F.R. § 205.13 (retention of electronic funds transfer records).

[25] *See* Comptroller's Handbook, *Bank Supervision Process* (2007) (detailing the CAMELS rating system and standards for evaluating bank management).

communication with a municipal entity regarding its deposit account is both unnecessary and duplicative of the existing responsibilities concerning traditional banking products and services.

The Commission's proposal would exempt certain providers of letters of credit or liquidity facilities from the definition of "obligated persons."[26] However, it remains unclear whether a bank may fall within the definition of municipal advisor (and thus subject to registration) merely by providing a letter of credit to a municipal entity. We suggest that the Commission further clarify that banks providing letters of credit to municipal entities or obligated persons (without otherwise providing advice to them) also are exempt from the definition of "municipal advisor." National banks have long offered letters of credit and other liquidity facilities to their clients as traditional banking products.[27] Letters of credit and other liquidity facilities are subject to the same thorough regulation and supervision as other traditional banking products and services, and therefore further regulation of letters of credit issued by bank providers is unnecessary and duplicative.[28] Therefore, we encourage the Commission to clarify that providers of letters of credit or other liquidity facilities are exempt from the definition of "municipal advisor."

Treatment of Bank Trust and Fiduciary Services

Section 975 and the Proposed Rules would require persons who advise municipal entities on municipal financial products, including "investment strategies," to register as municipal advisors.[29] Trust and fiduciary services offered by banks, which are already subject to extensive standards, may fall within this definition.[30] Thus, banks providing advice to municipal entities related to these services could be required to register as municipal advisors under the Proposed Rules, making them subject to the municipal advisor regulatory framework.[31] In addition to the

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[26] 76 Fed. Reg. at 881-882 (proposed rule 15Ba1-1(i), to be codified at 17 C.F.R. § 240.15Ba1-1(i)) (excluding providers of municipal bond insurance, letters of credit, or other liquidity facilities from the definition of obligated person).

[27] *See, e.g.*, 12 U.S.C. § 24(Seventh); 12 U.S.C. § 84; 12 C.F.R. Part 5; 12 C.F.R. § 7.1016 (issuance of letters of credit); 12 C.F.R. § 32.2(t) (standby letter of credit); OCC Interpretive Letter No. 494 (Dec. 20, 1989) (confirming letters of credit are part of the business of banking authorized for national banks). *See also* 15 U.S.C. § 78c note (letters of credit, banker's acceptances, and loan participations as identified banking products).

[28] *See, e.g.*, 12 C.F.R. Part 32 (legal lending limits); 12 C.F.R. Part 215 (regulation of loans to bank insiders); Comptroller's Handbook, *Trade Finance* (1998); Federal Reserve Board Commercial Bank Examination Manual, *Liabilities and Capital* (2006).

[29] 76 Fed. Reg. at 830 (the Proposed Rules expand the definition of investment strategies to include plans, programs, and pools of assets that invest municipal funds).

[30] 76 Fed. Reg. at 837 (requesting comment on whether banks providing fiduciary services to municipal entities should be excluded from the definition of municipal advisor).

[31] Similarly, the extent to which banks providing traditional custodial services may be encompassed by the definition of municipal advisor is unclear, and we suggest the SEC provide clarification that those activities also are exempt.

registration requirements, Section 975 imposes on municipal advisors a new fiduciary duty to their municipal entity clients.[32]

Trust, fiduciary, and custody services are core banking functions. Banks have long provided these services to municipal entities as an integral part of the asset management and advisory services that banks provide to all of their trust, fiduciary, and custody customers.[33] National banks must comply with federal statutes, regulations issued by the federal banking agencies, and supervisory guidance specifically governing banks providing trust, fiduciary, and custody products and services.[34] Throughout the course of the banking relationship, a national bank may provide to its clients a variety of services upon which the OCC imposes a fiduciary obligation.[35] For example, the OCC's Part 9 regulation sets forth specific fiduciary standards governing the national banks that provide investment advice to any customer for a fee.[36] Moreover, banks are subject to fiduciary standards under federal and state laws intended to protect trust beneficiaries, retirement plan participants, municipal entities, and other types of investors.[37] The OCC also requires national banks utilizing their fiduciary powers granted in 12 U.S.C. § 92a to keep separate, detailed records of all fiduciary-related transactions.[38] The OCC supervises the fiduciary activities of banks through regular and extensive on-site examinations to ensure bank compliance with all fiduciary obligations.[39]

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[32] 15 U.S.C. § 78o-4(c)(1) ("municipal advisor and any person associated with such municipal advisor shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts as a municipal advisor, and no municipal advisor may engage in any act, practice, or course of business which is not consistent with a municipal advisor's fiduciary duty or that is in contravention of any rule of the [MSRB]"). *See also* MSRB Notice 2011-12 (Feb. 14, 2011) (draft Rule G-36 to prohibit activities inconsistent with this fiduciary duty).

[33] *See* Comptroller's Handbook, *Asset Management* (2000); Comptroller's Handbook, *Custody Services* (2002); OCC Interpretive Letter No. 1078 (Apr. 19, 2007) (national banks' custody activities are permissible banking activities often offered in conjunction with the delivery of fiduciary services.); OCC Interpretive Letter No. 695 (Dec. 8, 1995) (scope of the exercise of national bank fiduciary powers).

[34] *See* 12 U.S.C. § 92a (trust powers of national banks); 12 C.F.R. § 5.26 (licensing requirements for fiduciary powers); 12 C.F.R. Part 9 (fiduciary activities of national banks); Comptroller's Handbook, *Asset Management Operations and Controls* (2011); Comptroller's Handbook, *Custody Services* (2002); Comptroller's Handbook, *Asset Management* (2000).

[35] 12 C.F.R. § 9.2(e) (defining fiduciary capacity).

[36] *See* 12 C.F.R. § 9.2(e) (fiduciary capacity includes providing investment advice for a fee); 12 C.F.R. § 9.101 (explaining the types of investment advice that subjects banks to a fiduciary duty).

[37] *See, e.g.,* Employee Retirement and Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 et seq.; 12 C.F.R. Part 12 (recordkeeping requirements).

[38] *See* 12 U.S.C. § 92a(c), 12 C.F.R. § 9.8; 12 C.F.R. § 12.3.

[39] *See* Comptroller's Handbook, *Retirement Plan Services* (2007); Comptroller's Handbook, *Investment Management Services* (2001); Comptroller's Handbook, *Asset Management* (2000); Comptroller's Handbook, *Conflicts of Interest* (2000). *See also* Comptroller's Handbook, *Bank Supervision Process* (2007) (highlighting the increased reputation risk exposure that accompanies fiduciary services).

By establishing the municipal advisor framework, Congress sought to increase transparency, restrict conflicts of interest, promote fair dealing, and prohibit fraudulent practices.[40] However, as described above, banks acting in a fiduciary capacity already are subject to extensive and significant prudential regulation, including strict fiduciary duty obligations, that ensure banks provide trust and fiduciary customers with fair treatment. In this context the regulation of banks as municipal advisors is unnecessary and duplicates the existing obligations already imposed on bank fiduciaries.

Municipal Securities Purchases and Requests for Proposals ("RFPs")

The Proposed Rules also should clarify that banks would not be deemed to be providing "advice" to a municipal entity simply by providing terms upon which the bank would purchase for the bank's own account securities issued by the municipal entity, such as bond, tax, and revenue anticipation notes. Responses to RFPs from a municipal entity regarding certain investment products the banks offer, such as money market mutual funds or exempt securities, also should not be treated as "advice" for the reasons discussed below.

Municipal entities often issue RFPs to banks to obtain funding to meet the municipal entity's operating needs. Banks respond to the RFPs on a competitive basis, providing the municipality with alternative mechanisms such as bond, tax, and revenue anticipation notes to meet their short-term operating needs. Banks also are asked to respond to RFPs related to the investment of operating funds received from tax collections and other sources. Many municipalities are required by statute to issue RFPs to banks for their operating accounts. The operating accounts take the form of checking accounts, often with sweeps into mutual funds, repurchase agreements, and certificates of deposit. Banks are chosen by competitive bid, with the business going to lowest cost and highest yield offer to the municipality. Theses services have long been a customary course of dealing between banks and municipalities. Banks providing products and services offered in response to RFPs are subject to stringent regulation and oversight by prudential regulators.[41]

Furthermore, banks providing terms for the purchase of municipal securities for the bank's own account should be excluded from registration as "municipal advisors." Banks are authorized to purchase municipal securities for their own account, subject to extensive regulation and oversight.[42] Again, these activities already are monitored for compliance with the existing

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[40] S. Rep. No. 111-176 at 149.

[41] *See, e.g.*, 12 U.S.C. § 24(Seventh); 12 C.F.R. Part 7; Comptroller's Handbook, *Bank Supervision Process* (2007); Comptroller's Handbook, *Asset Management* (2000); Comptroller's Handbook, *Large Bank Supervision* (2010); Comptroller's Handbook, *Community Bank Supervision* (2010).

[42] *See, e.g.*, 12 U.S.C. § 24(Seventh); 12 C.F.R. Part 1 (permissible investment securities); 12 C.F.R. Part 30 (safety and soundness standards); Comptroller's Handbook, *Bank Supervision Process* (2007); An Examiner's Guide to Investment Products and Practices (1992); Comptroller's Handbook for National Bank Examiners, § 203.1 *Investment Securities* (1990).

regulatory framework during regular and thorough on-site examinations, and additional oversight is unnecessary and would be duplicative.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

United States Senate
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510–6075

November 9, 2011

The Honorable Ben Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave, NE
Washington, D.C. 20551

Mr. Raj Date
Special Advisor to the Secretary of the Treasury
Consumer Financial Protection Bureau
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Washington, D.C. 20036

The Honorable Martin Gruenberg
Acting Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Mr. Edward DeMarco
Acting Director
Federal Housing Finance Agency
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The Honorable Debbie Matz
Chairman
National Credit Union Administration
1775 Duke St.
Alexandria, VA 22314

Mr. John Walsh
Acting Comptroller
Office of the Comptroller of the Currency
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Washington, DC 20219

The Honorable Gary Gensler
Chairman
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

The Honorable Mary Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chairmen, Directors, and Advisor:

As you know, the key to designing and maintaining effective financial rules is taking a smart regulatory approach that, over the long run, provides the greatest benefit at the lowest cost to society as a whole. This approach should promote public participation and consider a wide range of factors for each rule you write. It should also ensure that new and existing regulations work together in concert to provide clear direction to those entities you supervise, as well as provide robust safeguards for those whom the rules are designed to protect.

We must not forget that our economy suffered from inadequate regulations that contributed to the worst financial crisis since the Great Depression. American families and small businesses bore tremendous costs in lost jobs, homes, and savings. In response, Congress enacted the Wall Street

Reform and Consumer Protection Act to address regulatory gaps and enhance protections for consumers, investors, and taxpayers while ensuring our financial markets remain the envy of the world. The long-term success of these reforms depends upon your agencies crafting clear, effective and robust financial regulations that build a stronger foundation for sustainable economic growth.

Efforts to repeal or undermine these new Wall Street reforms threaten the stability of our financial system at a time when we can least afford it. These efforts to slow down Wall Street reform prevent responsible businesses, including community banks and credit unions, from having the certainty they deserve with finalized rules that fully honor Congressional intent behind the new law. To ensure the Wall Street Reform Act continues to be implemented thoughtfully and responsibly with full consideration of relevant issues, we respectfully ask that you send us a written response to the following requests:

1. Provide a detailed description of your agency's rulemaking process, including the variety of economic impact factors considered in your rulemaking. Please note to what degree you consider the benefits from your rulemaking, including providing certainty to the marketplace and preventing catastrophic costs from a financial crisis. Also describe any difficulties you may have in quantifying benefits and costs, as well as any challenges you may face in collecting the data necessary to conduct economic analysis of your rulemaking.

2. Provide your agency's current and future plans to regularly review and, when appropriate, modify regulations to improve their effectiveness while reducing compliance burdens. Please include a description of actions your agency has taken, or plans to take, to streamline regulations; for example, the Consumer Financial Protection Bureau's "Know Before You Owe" effort drastically simplifies mortgage and student loan disclosure requirements. Also note statutory impediments, if any, that prevent your agency from streamlining any duplicative or inefficient rules under your purview.

3. Provide details of how your agency encourages public participation in the rulemaking process, including through administrative procedures, public accessibility, and informal supervisory policies and procedures.

4. Provide details of how your agency addresses the unique challenges facing smaller institutions when dealing with regulatory compliance, including any related advisory committees your agency may have or other opportunities for small institutions to be heard by your agency. Please also detail how your agency responds to concerns raised by small institutions.

5. Describe how regulatory interagency coordination has improved since the creation of the Financial Stability Oversight Council established by the Wall Street Reform Act. Provide specifics of how coordination has helped, either formally or informally, in your rulemaking process.

Strong financial regulations will greatly benefit the American people for generations to come. Robust and efficient regulations will provide greater certainty to the marketplace, and will restore the business and consumer confidence necessary for economic growth. They will also provide greater clarity to American consumers and investors so that they are empowered to make sound financial decisions. Thank you for your consideration, and we look forward to working with you.

Sincerely,

TIM JOHNSON
Chairman

THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D C 20549

December 20, 2011

The Honorable Tim Johnson
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Johnson:

Thank you for your November 9, 2011 letter regarding the rulemaking approach of the federal financial regulators. I share your view that the approach should promote public participation, consider a wide range of factors, result in regulations that work in concert with other regulations to provide clear direction to the entities we regulate, and provide robust safeguards for those whom the rules are designed to protect. You asked for a response to a number of questions to ensure that the Dodd-Frank Wall Street Reform and Consumer Protection Act continues to be implemented thoughtfully and responsibly with full consideration of relevant issues. Your questions and my responses appear below.

1. ***Provide a detailed description of your agency's rulemaking process, including the variety of economic impact factors considered in your rulemaking. Please note to what degree you consider the benefits from your rulemaking, including providing certainty to the marketplace and preventing catastrophic costs from a financial crisis. Also describe any difficulties you may have in quantifying benefits and costs, as well as any challenges you may face in collecting the data necessary to conduct economic analysis of your rulemaking.***

The Commission's rulemaking process is governed by the Administrative Procedure Act ("APA") and other federal statutes that prescribe the manner in which the Commission may undertake to consider or adopt rules of general applicability. In general, the Commission engages in "informal" rulemaking,[1] in which it seeks comments in advance from the public before adopting substantive regulations or amendments to existing regulations.

The APA requires that agencies provide interested parties with adequate notice of proposed rulemaking and the opportunity to participate in the rulemaking "through submission of

[1] "Informal" rulemaking is distinct from "formal" rulemaking. Sections 556 and 557 of the APA provide procedures that apply to "rules [that] are required by statute to be made on the record after opportunity for an agency hearing." 5 U.S.C. § 553. Known generally as "formal" rulemakings, these rulemakings require oral evidentiary hearings that employ special procedures analogous to those used in judicial trials. See 5 U.S.C. §§ 556, 557.

written data, views, or arguments...."[2] The Commission's practice in this type of "notice and comment" rulemaking generally proceeds as follows. First, the Commission publishes a "proposing release" for the rulemaking in the *Federal Register*. This document sets forth the text of the proposed rule, describes and explains the proposed rule, and solicits comments, including relevant data, from members of the public. Typically, one or more of the Divisions of the Commission has been responsible for preparation of the proposing release, following extensive analysis of an issue, consideration of alternatives, and consultation with other Commission staff and the Commissioners. The staff's final recommendation is presented to Commission for its approval, and typically the Commission holds an open meeting under the Government in the Sunshine Act to consider the recommendation and vote on approving it for publication in the *Federal Register*.[3]

After the proposing release is published, there is a period of time in which the public may provide its comments. The proposing release invites comment from the public on all aspects of the proposed rule, including on specific questions about the operation of details of the proposed rule or alternatives to the proposal. The Commission places copies of comment letters submitted, as well as any other data or information important to the Commission's consideration of the rulemaking, into the public rulemaking file. The public also is invited to submit comments by e-mail. Submitted comments generally are available on the Commission's website. The Commission staff and Commissioners also may meet with interested parties concerning the rulemaking, and memoranda of such meetings are generally placed in the public comment file.

After the comment period closes, the staff and Commission complete their analysis of the comment letters. In making a recommendation to the Commission on how to proceed, the staff will consider the comments provided in determining whether to adopt the rule as proposed, modify the rule to respond to issues raised in the comments, or substantially reconsider or revise the approach contained in the proposed rule. If the Commission determines to proceed with an approach significantly different from the rules proposed, it may need to re-propose the rules in order to give the public adequate notice and the opportunity to comment on the re-proposed rules.

A Commission vote to adopt final rules generally occurs at an open meeting, although it may occur through seriatim vote. If the Commission approves adoption of the rules, the Commission publishes a release in the *Federal Register*, with an explanation of the reasons for adoption and responses to the more salient issues raised in the comment letters. The rules are generally effective no earlier than 30 days after publication in the *Federal Register*, although the APA permits more immediate effectiveness in certain circumstances.[4]

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[2] 5 U.S.C. § 553(c). An agency may adopt substantive rules without prior notice and comment in limited circumstances. See 5 U.S.C. § 553(b). The Commission does not frequently use this procedure

[3] On occasion, the Commission may vote on a rulemaking proposal without a Commission meeting, through its seriatim voting process See 17 CFR 200.42.

[4] See 5 U.S.C. § 553(d) (effectiveness in less than 30 days is permissible if (1) rule is a substantive rule that grants an exemption or relieves a restriction, (2) rule is an interpretative rule or statement of policy, or (3) agency finds good cause for more immediate effectiveness). If the rule is "major" under the Congressional Review Act, it may not be effective for 60 days after publication in the *Federal Register*.

Economic Factors Considered in Commission Rulemaking - The Commission considers many factors in its rulemakings. In some cases, the authorizing statutes direct the Commission to consider particular elements relevant to those particular rules. In others, the statute directs the Commission more generally to consider the "public interest" or the "protection of investors." In addition to these matters, however, the Commission also considers a variety of economic factors. In some cases, these are considerations specifically required by statute. For example, the securities laws require the Commission, when it engages in rulemaking and is required to consider or determine whether the rulemaking is in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[5] In addition, Section 23(a) of the Exchange Act requires the Commission, in making rules and regulations pursuant to the Exchange Act, to consider among other matters the impact any such rule or regulation would have on competition. The agency may not adopt a rule under the Exchange Act that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

The Commission also considers the costs and benefits of rules as a regular part of the rulemaking process. We are keenly aware that our rules have both costs and benefits, and that the steps we take to protect the investing public impact both financial markets and industry participants who must comply with our rules. This is especially relevant given the scope, significance, and complexity of the Dodd-Frank Act. The SEC's Division of Risk, Strategy, and Financial Innovation ("RSFI") directly assists in the rulemaking process by helping to develop the conceptual framing for, and assisting in the subsequent writing of, the economic analysis sections of the Commission's rulemaking releases.

It is important to recognize that cost-benefit analysis is a tool that informs the rule making process and is not designed to be the sole determinant of whether a rule should be adopted. Economic analysis of agency rules considers the direct and indirect costs and benefits of the Commission's proposed decisions in comparison with those of alternative approaches. Analysis of the likely economic effects of proposed rules, while critical to the rulemaking process, can be challenging.

Certain costs or benefits may be difficult to quantify or value with precision, particularly those that are indirect or intangible.[6] The primary difficulties can be traced to the absence of suitable data. This situation often arises in rulemaking because many rules are designed to modify the behavior of market participants in response to perceived problems. When there are no precedents that can be used as a basis for analysis, it is impossible to rigorously predict anticipated responses to proposed regulations. In addition, relevant data are often only available from certain market participants. During the comment process, the SEC may ask the public to

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[5] See Securities Act § 2(b); Exchange Act § 3(f); Investment Company Act § 2(c); and Advisers Act § 202(c).

[6] In its report discussing cost-benefit analyses of Dodd-Frank Act rulemaking by financial regulators, the GAO noted that "the difficulty of reliably estimating the costs of regulations to the financial services industry and the nation has long been recognized, and the benefits of regulation generally are regarded as even more difficult to measure." GAO-12-151, p. 19; see also GAO-08-32.

quantify their estimates of cost and benefits, especially when the dollar costs of proposed rulemaking are known only to or best determined by market participants. Although this can be an effective method for obtaining data, it may be burdensome to the individuals and firms to actually provide it and such data may to be biased in favor of the respondent's preferred outcome.

In light of recent court decisions, RSFI and the rule writing divisions are examining improvements in the economic analysis the SEC employs in rulemaking. Although the existing procedures and policies are designed to provide a rigorous and transparent economic analysis, we are taking steps to improve this process so that future rules are consistent with best practices in economic analysis.

When engaging in rulemaking, the Commission invites the public to comment on our analysis and provide any information and data that may better inform our decision making. In adopting releases, the Commission responds to the information provided and revises its analysis as appropriate. This approach promotes a regulatory framework that strikes an appropriate balance between the costs and the benefits of regulation.[7]

The Commission's ability to gather data for use in its cost-benefit analysis is constrained in some respects by administrative laws, such as the Paperwork Reduction Act, although the Dodd-Frank Act provides the Commission with some relief from the data gathering constraints of the Paperwork Reduction Act in the rulemaking context.[8]

Regulatory Flexibility Act Analysis - The Regulatory Flexibility Act ("Reg Flex Act")[9] requires agencies, when proposing or adopting rules, to consider the special needs of small businesses. When an agency publishes a notice of proposed rulemaking, the Reg Flex Act generally requires the agency to prepare and make available for public comment an initial regulatory flexibility

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[7] After reviewing cost-benefit analyses included in six of our Dodd-Frank Act rulemaking releases, the SEC's Inspector General issued a report in June 2011. While the IG is continuing to review the Commission's cost-benefit analyses, this report concluded that "a systematic cost-benefit analysis was conducted for each of the six rules reviewed. Overall, [the OIG] found that the SEC formed teams with sufficient expertise to conduct a comprehensive and thoughtful review of the economic analysis of the six proposed released that [the OIG] scrutinized in [its] review." See U.S. SEC Office of the Inspector General, Report of Review of Economic Analyses Performed by the Securities and Exchange Commission in Connection with Dodd-Frank Rulemakings (June 13, 2011) http://www.sec-oig.gov/Reports/AuditsInspections/2011/Report_6_13_11.pdf at 43. We look forward to continuing to work with the OIG as it conducts a further review.

[8] Securities Act Section 19(e), as added by Section 912 of the Dodd-Frank Act, provides that, for the purpose of evaluating any rule or program of the Commission issued or carried out under any provision of the securities laws and the purposes of considering proposing, adopting, or engaging in any such rule or program or developing new rules or programs, the Commission may: (1) gather information from and communicate with investors or other members of the public; (2) engage in such temporary investor testing programs as the Commission determines are in the public interest or would protect investors; and (3) consult with academics and consultants. Securities Act Section 19(f) provides that any action taken under Section 19(e) will not be construed to be a collection of information for purposes of the Paperwork Reduction Act.

[9] 5 U.S.C. §§ 601-612

analysis ("IRFA") that describes the impact of the proposed rule on small entities.[10] Among other things, the IRFA must describe the significant alternatives to the rules that the agency has considered that would accomplish the stated objectives of the applicable statute while minimizing any significant economic impacts of the proposed rules on small entities. When an agency publishes a final rule, the agency must prepare and make available to the public a final regulatory flexibility analysis ("FRFA"). Among other things, the FRFA must include a statement of the significant issues raised by the public comments in response to the IRFA, a statement of the assessment of the agency of such issues, and a statement of any changes made in the proposed rule as a result of such comments.

Paperwork Reduction Act Analysis - The Paperwork Reduction Act of 1980[11] was intended to reduce federal paperwork burdens on individuals and companies. A federal agency generally may not conduct or sponsor a "collection of information" without the approval of OMB. In general, each time the Commission requires or requests information from ten or more persons by asking identical questions, such as through a form or other disclosure requirement, it must first obtain OMB approval. For rules proposed for public comment, the Commission generally submits the rule and an estimate of the rule's paperwork burden to OMB at the time it publishes the proposed rule in the *Federal Register*.

The proposing release for a rule solicits specific comments concerning the proposed collection of information, including: whether the proposed collection of information is necessary for the proper performance of the functions of the agency; whether the agency's estimate of the burden of the proposed collection of information is accurate; whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and whether there are ways to minimize the burden of collection of information on those who are to respond.

The adopting release for a rule summarizes: any comments received and explains the agency's response to the comments; explains any modification made to the rule as it applies to the collection of information, and why the modification was made; and reports any changes to the burden estimate, purpose, use, or necessity of the collection of information.

"Major" Rule Analysis - Under the Small Business Regulatory Enforcement Fairness Act of 1996,[12] a rule generally cannot take effect until the Commission submits a report on the rulemaking (regardless of its impact on small entities) to each House of Congress and the Comptroller General of the Government Accountability Office. The report generally includes: a copy of the rule, general statement on major/non-major status, proposed effective date of the rule, cost-benefit analysis, Reg Flex Act compliance, and any other relevant information. If a

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[10] Under the Reg Flex Act, the Commission is required to consider impacts on the small entities to which a rule directly applies; the Commission also typically considers indirect economic impacts as part of its broader economic analysis. The Reg Flex Act provides that agencies do not need to prepare initial and final regulatory flexibility analyses if the head of the agency certifies that the rule will not, if promulgated, "have a significant economic impact on a substantial number of small entities." 5 U.S.C. § 605(b).

[11] 44 U.S.C. §§ 3501-3520.

[12] Pub. L. No. 104-121, Title II, 110 Stat. 847, 857 (1996).

rule is "major," its effectiveness generally will be delayed for a 60-day period pending Congressional review.[13] SEC staff provide an initial analysis to OMB, which makes the final determination as to whether a rule is "major." The Act provides Congress with a special procedural mechanism for overriding an agency rule during a defined period after receipt of an agency's rulemaking report.

2. Provide your agency's current and future plans to regularly review and, when appropriate, modify regulations to improve their effectiveness while reducing compliance burdens. Please include a description of actions your agency has taken, or plans to take, to streamline regulations; for example, the Consumer Financial Protection Bureau's "Know Before You Owe" effort drastically simplifies mortgage and student loan disclosure requirements. Also note statutory impediments, if any, that prevent your agency from streamlining any duplicative or inefficient rules under your purview.

The Commission and staff currently have formal and informal processes for identifying existing rules for review and for conducting those reviews to assess the rules' continued utility and effectiveness in light of the continuing evolution of the securities markets and changes in the securities laws and regulatory priorities. Which process or processes may apply in the case of a given rule may vary depending on multiple factors.

One of the ongoing processes for review of existing rules is the review process under Section 610(a) of the Reg Flex Act, which requires an agency to review its rules that have a significant economic impact upon a substantial number of small entities within 10 years of the publication of such rules as final rules. The purpose of the review is "to determine whether such rules should be continued without change, or should be amended or rescinded ... to minimize any significant economic impact of the rules upon a substantial number of small entities." The Reg Flex Act sets forth specific considerations that must be addressed in the review of each rule: (i) the continued need for the rule; (ii) the nature of complaints or comments received concerning the rule from the public; (iii) the complexity of the rule; (iv) the extent to which the rule overlaps, duplicates, or conflicts with other federal rules, and, to the extent feasible, with state and local governmental rules; and (v) the length of time since the rule has been evaluated or the degree to which technology, economic conditions, or other factors have changed in the area affected by the rule.

The Commission annually publishes a list of rules that are scheduled to be reviewed by the Commission staff during the next 12 months pursuant to Section 610(a) of the Reg Flex Act. The Commission's stated policy is to conduct such a 10-year review of all final rules to assess not only their continued compliance with the Reg Flex Act, but also to assess generally their

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[13] A rule is major if OMB determines that it is likely to result in: (1) an annual effect on the economy of $100 million or more, (2) a major increase in costs or prices for consumers or individual industries, or (3) significant adverse effects on competition, employment, investment, productivity, innovation or the ability of U.S.-based enterprises to compete with foreign-based enterprises in domestic export markets. See 5 U.S.C. § 804.

continued utility.[14] The list published by the Commission, therefore, may be broader than that required by the Reg Flex Act, because it may include rules that do not have a significant economic impact on a substantial number of small entities. In publishing the list, the Commission solicits comments generally on the listed rules, and particularly on whether the rules affect small businesses in new or different ways than when they were first adopted. The Commission accepts comments electronically – through a comment form on the Commission's website, an e-mail comment box, or the Federal eRulemaking Portal – or in paper mailed to the Commission's Secretary.

In addition to the annual list of rules scheduled for a 10-year review, the Commission also publishes twice yearly an agenda of anticipated rulemaking actions pursuant to section 602(a) of the Reg Flex Act. While the Reg Flex Act requires these semi-annual agendas to include only rules that are likely to have a significant economic impact on a substantial number of small entities, the Commission's general practice has been to include in its agendas all anticipated rulemakings for which it has provided or will provide notice and comment, regardless of their impact on small entities. The complete agenda is available at www.reginfo.gov, and information on regulatory matters in the agenda is available at www.regulations.gov.[15] The agenda includes both potential changes to existing rules, including rescission, and new rulemaking actions. The Commission publishes a notice of each agenda on its website and invites questions and public comment, through the electronic or paper means described above, on the agenda and on the individual agenda entries.

The SEC currently plans to review a number of existing rules pursuant to these processes. For example, the Commission's semi-annual rulemaking agenda under the Reg Flex Act lists a number of existing rules that are under consideration for revision. In addition, as discussed in more detail below, I recently instructed the staff to take a fresh look at the SEC's existing offering rules to develop ideas for the Commission to consider that would reduce the regulatory burdens on small business capital formation in a manner consistent with investor protection.

In addition, on September 6, 2011, the Commission published a Request for Information in the Federal Register, on the Commission's Web site, and on the Federal eRulemaking Portal (www.regulations.gov). The Request for Information invited interested members of the public to submit comments to assist the Commission in considering the development of a plan for the retrospective review of its regulations. The comment period closed on October 6, 2011. We received over 70 comments, which we are in the process of considering.

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[14] When the Commission implemented the Reg Flex Act in 1980, it stated that it "intend[ed] to conduct a broader review [than that required by the RFA], with a view to identifying those rules in need of modification or even rescission." Securities Act Release No. 6302 (Mar. 20, 1981), 46 Fed. Reg. 19251 (Mar. 30, 1981).

[15] The agenda also is published in the *Federal Register*, but the version of the agenda published in the *Federal Register* includes only those rules for which the agency has indicated that preparation of a Reg Flex Act analysis is required (i.e., rules that are likely to have a significant economic impact on a substantial number of small entities).

3. Provide details of how your agency encourages public participation in the rulemaking process, including through administrative procedures, public accessibility, and informal supervisory policies and procedures.

Public comment is vitally important to the Commission's rulemaking. As discussed earlier, the Commission generally engages in rulemaking in which it publishes notice of proposed rules and seeks public comment before adopting substantive regulations or amendments to existing regulations. The notice and comment period provides market participants, investors, regulated parties, and other interested persons the opportunity to offer views and suggestions on our proposals, as well as empirical data regarding their impact. It is important to note that the Commission generally considers comments received even after the expiration of the comment period. In addition, the Commission has reopened or extended comment periods in appropriate circumstances to provide additional opportunities for comment.

The views and data received from comments provide invaluable information that helps the Commission in crafting final rules that further our mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. We carefully review and analyze the comments received on our proposed rules, and address comments in our releases adopting final rules. In doing so, we coordinate the review across the agency so that appropriate staff expertise can be brought to bear on rulemaking.

Recognizing the importance of the rulemakings required under the Dodd-Frank Act, the Commission expanded its open and transparent rulemaking process shortly after the Act was signed into law by providing an opportunity for public input even before issuing formal rule proposals. To facilitate early public comment on Dodd-Frank implementation, the Commission made available a series of e-mail boxes, organized by topic, to receive preliminary views from the public. These e-mail boxes are on the SEC website. In addition, our staff has sought the views of affected stakeholders and the public. This approach has resulted in hundreds of meetings with a broad cross-section of interested parties. To further this public outreach effort, the SEC staff has held joint public roundtables with the Commodity Futures Trading Commission staff on select key topics. Through these processes, we have received a wide variety of views and information that is useful to us in proposing and, ultimately, adopting rules. The SEC also hosted a roundtable on the agency's required rulemaking under Section 1502 of the Dodd-Frank Act, which relates to reporting requirements regarding conflict minerals originating in the Democratic Republic of the Congo and adjoining countries.

4. Provide details of how your agency addresses the unique challenges facing smaller institutions when dealing with regulatory compliance, including any related advisory committees your agency may have or other opportunities for small institutions to be heard by your agency. Please also detail how your agency responds to concerns raised by small institutions.

In promulgating rules, the SEC takes into account the rules' impact on smaller institutions. As discussed above, the Reg Flex Act requires federal agencies, including the SEC, to consider the impact of regulations on small entities in developing proposed and final regulations and to consider alternatives that would lower the burden on small entities. Consistent

with that Act, whenever notice and comment on a rulemaking is required, the SEC analyzes the rulemaking's effects on small businesses and alternatives.

We anticipate that an analysis under the Reg Flex Act will be required for almost all of the rules that the SEC promulgates under the Dodd-Frank Act, and the SEC already has provided targeted relief to smaller institutions in a number of the rules that it has adopted under the Dodd-Frank Act. For example, in implementing Sections 404 and 406 of the Dodd-Frank Act, which require certain advisers to hedge funds and other private funds to report information for use by the Financial Stability Oversight Council, the SEC divided advisers by size into two broad groups – large advisers and smaller advisers. For smaller advisers, the amount of information reported and the frequency of reporting is much less than for larger advisers. In addition, in connection with the Commission's rules under Section 951 of the Dodd-Frank Act, which require issuers to provide for periodic votes on executive compensation and the frequency of those votes, we provided additional time for smaller reporting companies to comply with those requirements.

The SEC also is committed to reviewing the impact of existing rules on smaller institutions. As discussed earlier, Section 610 of the Reg Flex Act requires an agency to review its rules that have a significant economic impact upon a substantial number of small entities within 10 years of the publication of such rules as final rules.

Also, as noted above, I recently instructed the staff to take a fresh look at the SEC's offering rules to develop ideas for the Commission to consider that would reduce the regulatory burdens on small business capital formation in a manner consistent with investor protection. Areas of focus for the staff will include:

- the restrictions on communications in initial public offerings;
- whether the restrictions on general solicitation in private offerings should be revisited in light of current technologies, capital-raising trends, and our mandates to protect investors and facilitate capital formation;
- the number of shareholders that trigger public reporting, including questions surrounding the use of special purpose vehicles that hold securities of a private company for groups of investors; and
- regulatory questions posed by new capital raising strategies, such as crowdfunding.

In conducting this review, the staff will solicit input and data from multiple sources, including small businesses, investor groups, and the public-at-large. The review also will include the evaluation of recommendations from our SEC Government-Business Forum on Small Business Capital Formation (see the discussion below) and our recently-created Advisory Committee on Small and Emerging Companies, as well as suggestions we receive through the website solicitation of suggestions.

In addition to considering the regulatory compliance challenges of smaller institutions in promulgating and reviewing rules, the SEC provides these institutions with a number of avenues for airing their compliance concerns. The SEC holds an annual SEC Government-Business Forum on Small Business Capital Formation. This gathering has assembled annually since 1982, as mandated by the Small Business Investment Incentive Act of 1980. A major purpose of the Forum is to provide a platform for small businesses to highlight perceived unnecessary impediments to the capital-raising process. Previous Forums have developed numerous recommendations seeking legislative and regulatory changes in the areas of securities and financial services regulation, taxation and state and federal assistance. Participants in the Forum typically have included small business executives, venture capitalists, government officials, trade association representatives, lawyers, accountants, academics and small business advocates. In recent years, the format of the Forum typically has emphasized small interactive breakout groups developing recommendations for governmental action.

Our Compliance Outreach Program also provides a forum for regulated entities to learn about effective compliance practices, discuss compliance issues, and for senior officers to share experiences. The mission of the program is to improve compliance by opening the lines of communication between SEC staff and Chief Compliance Officers and other senior officers of registered broker dealers, investment advisers and investment companies. The program features a number of elements, including regional events at various locations across the country and national events sponsored in Washington, DC.

The Commission also recently established an Advisory Committee on Small and Emerging Companies. The Advisory Committee is intended to provide a formal mechanism through which the Commission can receive advice and recommendations specifically related to privately held small businesses and publicly traded companies with less than $250 million in public market capitalization. The members of the Advisory Committee include representatives from a range of small and emerging companies, and investors in those types of companies, with real world experience under our rules. The Advisory Committee held its first meeting on October 31, 2011, where it considered a number of issues related to capital formation for small and emerging companies, including the triggers for registration and public reporting and suspension of reporting obligations, possible scaling of regulations for newly public companies, crowdfunding, possible modifications to Regulation A, and the restrictions on general solicitation. We understand that the Advisory Committee intends to provide preliminary recommendations to the Commission on many of these topics in the coming weeks, and we look forward to receiving those recommendations.

5. Describe how regulatory interagency coordination has improved since the creation of the Financial Stability Oversight Counsel established by the Wall Street Reform Act. Provide specifics of how coordination has helped, either formally or informally, in your rulemaking process.

The Commission is committed to working closely, cooperatively, and regularly with our fellow regulators to strengthen our implementation of the regulatory structure established by the

Dodd-Frank Act and in carrying out our mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.

We meet regularly, both formally and informally, with other financial regulators. SEC staff working groups, for example, consult and coordinate with the staffs of the CFTC, Federal Reserve Board, and other federal regulators on implementation of Title VII of the Dodd-Frank Act. As you know, the SEC's rules will apply to security-based swaps, while the CFTC's rules will apply to swaps. Our objective is to establish consistent and comparable requirements, to the extent possible, for swaps and security-based swaps, taking into account differences in products, participants, and markets, and this objective will continue to guide our efforts as we move toward adoption. While, in some instances, the CFTC has released proposed rules before we have, in each of these cases, the rules were the subject of extensive interagency discussions.

In addition, as required by the Dodd-Frank Act, we are working with the CFTC to adopt joint rules further defining key definitional terms relating to the products covered by Title VII and certain categories of market intermediaries and participants. Joint rulemaking regarding key definitions will help to ensure regulatory consistency and comparability, and thus help to prevent gaps, regulatory arbitrage, and confusion.

Commission staff also is working closely with the Federal Reserve Board and the CFTC to develop, as required by Title VIII of the Dodd-Frank Act, a common framework to supervise financial market utilities, such as clearing agencies registered with the SEC, that are designated by the Financial Stability Oversight Council as systemically important. This framework provides for consulting and working together on examinations of systemically important financial market utilities consistent with Title VIII. This added layer of protection, or "second set of eyes," called for by the Act will help provide assurance that the U.S. financial system receives well coordinated oversight from all relevant supervisory authorities.

There has also been an extensive, collaborative effort by the Federal banking agencies, the SEC, the CFTC and our respective staffs to implement a number of other Dodd-Frank Act provisions. For example, the Commission joined its fellow regulators in issuing for public comment proposed risk retention rules for asset backed securities, the "Volcker Rule" prohibiting banking entities from engaging in proprietary trading and having certain relationships with hedge funds and private equity funds, and a rule governing the incentive-based compensation arrangements of certain financial institutions. We also jointly adopted with the CFTC, based on consultation with FSOC, a new rule that requires hedge fund advisers and other private fund advisers registered with the Commission to report systemic risk information on a new "Form PF."

Finally, because the world today is a global marketplace and what we do to implement many provisions of the Act will affect foreign entities, the Commission is consulting bilaterally and through multilateral organizations with counterparts abroad. The SEC and CFTC, for example, are directed by the Dodd-Frank Act to consult and coordinate with foreign regulators on the establishment of consistent international standards with respect to the regulation of swaps, security-based swaps, swap entities, and security-based swap entities. We believe that the

IOSCO Task Force on OTC Derivatives Regulation, which the SEC co-chairs, and other international forums will help us achieve this goal.

Thank you for your letter and your interest in our rulemaking approach. If you have any questions or would like to further discuss this letter, please feel free to contact me at (202) 551-2100, or have your staff call Eric Spitler, Director of the Office of Legislative and Intergovernmental Affairs, at (202) 551-2010.

Sincerely,

Mary L. Schapiro
Chairman

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

OFFICE OF THE CHAIRMAN

January 11, 2012

Honorable Tim Johnson
Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Johnson:

Thank you for your letter of November 9, 2011, regarding implementation of the important financial reforms mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

As you know, the Dodd-Frank Act vested the Federal Deposit Insurance Corporation with sole rule writing authority in two primary areas: orderly liquidation authority and deposit insurance reforms that strengthen the Deposit Insurance Fund (DIF). I am pleased to report that within one year after passage of the Dodd-Frank Act, the FDIC had completed five major final rules for which the Act granted it sole rulemaking authority. Those rulemakings included final rules implementing increases in deposit insurance coverage and the FDIC's enhanced authority to manage the DIF, which included adoption of a long-term fund management plan designed to maintain a positive fund balance even during a banking crisis while preserving steady and predictable assessment rates through economic and credit cycles. Furthermore, the FDIC has largely completed the core rulemakings necessary to carry out its systemic resolution responsibilities under the Dodd-Frank Act and has, along with Federal Reserve Board staff, started the process of engaging with individual companies on the preparation of their resolution plans.

As we proceed with implementing the Dodd-Frank Act, we are mindful that one of the critical lessons of history is that efficient and stable financial markets require clear regulatory guidelines that promote market discipline and sound risk management. The FDIC believes that, in crafting these rules, it is essential to solicit input from all interested parties to ensure the rulemaking process is open and transparent and to carefully consider alternative approaches to regulatory goals to minimize burden while maintaining supervisory standards. We believe that successful implementation of the Act will represent a significant step forward in providing a foundation for a financial system that is more stable and less susceptible to crises in the future and better prepared to respond to future crises.

We are working on a number of fronts to achieve that necessary balance, as described more fully in the enclosed responses to your questions. Also enclosed is the FDIC's current statement of policy providing direction on rulemaking at the FDIC. One of the main purposes of the policy statement is to ensure that our rulemaking process achieves legislative goals effectively and efficiently. We also are enclosing our recently issued regulatory review plan and examples of the kinds of analyses the FDIC undertakes for rulemakings.

If you have further questions, please do not hesitate to call me at (202) 898-3888 or Paul Nash, Deputy to the Chairman for External Affairs, at (202) 898-6962.

Sincerely,

Martin J. Gruenberg

Martin J. Gruenberg
Acting Chairman

Enclosures

FDIC Responses to Questions from
Chairman Johnson, Senate Committee on
Banking Housing and Urban Affairs
on the Rulemaking Process

Q1. Provide a detailed description of your agency's rulemaking process, including the variety of economic impact factors considered in your rulemaking. Please note to what degree you consider the benefits from your rulemaking, including providing certainty to the marketplace and preventing catastrophic costs from a financial crisis. Also describe any difficulties you may have in quantifying benefits and costs, as well as any challenges you may face in collecting the data necessary to conduct economic analysis of your rulemaking.

A1: In our experience, there is no doubt that banks, consumers, and members of the public benefit from having clear rules and procedures, which provide much needed certainty in the marketplace. There are several ways the FDIC works to achieve this. First, the FDIC conducts all rulemakings in accordance with the requirements of the Administrative Procedure Act (APA).[1] The FDIC satisfies all of the basic requirements for informal rulemakings under the APA, which generally include the following:[2]

- publication of a Notice of Proposed Rulemaking (NPR) in the Federal Register;
- opportunity for public participation by submission of written comments;
- consideration by the agency of the public comments and other relevant material; and
- publication of a final rule not less than 30 days before its effective date, with a statement explaining the purpose of the rule.

The FDIC also is subject to certain other laws to minimize regulatory burden and has taken actions, including interagency coordination, to reduce burden and provide certainty to the marketplace. These laws include:

- **Regulatory Flexibility Act:** Requires agencies to conduct and publish an initial regulatory flexibility analysis that describes the impact of a proposed rule on small entities or certify that the final rule does not have a significant economic impact on a substantial number of small entities (financial institutions with total assets of $175 million or less under current Small Business Administration standards).[3]
- **Paperwork Reduction Act:** Requires agencies that conduct or sponsor a "collection of information" from the public to file a request with the Office of

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[1] 5 U.S.C. § 500 *et seq*

[2] 5 U.S.C. § 553.

[3] 5 U.S.C. §§ 601-12.

Management and Budget (OMB) for approval, to minimize burden for individuals and small businesses and cost to the federal government.[4]

- **Section 722 of the Gramm-Leach-Bliley Act:** Requires the federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000.[5]
- **Section 302 of the Riegle Community Development and Regulatory Improvement Act:** In determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements, requires federal banking agencies to consider any administrative burdens that the regulation would place on depository institutions, including small depository institutions and bank customers, and the benefits of the regulation.[6]
- **Section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA):** Requires federal banking agencies to conduct a comprehensive review of each of their regulations every 10 years to identify any outdated, unnecessary, or unduly burdensome regulatory requirements imposed on regulated financial institutions.[7]
- **Small Business Regulatory Enforcement Fairness Act (SBREFA):** Requires agencies to determine whether a rule is a "major rule" (a final rule that will result in a significant impact on the economy, consumers, industry, or government) and to file reports with Congress and the U.S. Government Accountability Office (GAO) for review of rules issued under the APA.[8]

Since 1998, the FDIC has had a *Statement of Policy on the Development and Review of FDIC Regulations and Policies* (Policy Statement), which enumerates basic principles that guide the FDIC's development and review of rulemaking (Attachment 1). Our Policy Statement provides that the FDIC "is committed to improving the quality of its regulations and policies, to minimizing regulatory burdens on the public and the banking industry, and generally to ensuring that its regulations and policies achieve legislative goals effectively and efficiently."[9] In the FDIC's recently issued regulatory review plan, we committed to reviewing the Policy Statement to determine whether incorporating additional principles regarding cost-benefit analysis or making other changes would better serve the purpose of reducing regulatory burden. A copy of the FDIC's regulatory review plan is enclosed as Attachment 2.[10]

With respect to economic impact factors considered in rulemakings, our current procedures allow staff the discretion and flexibility necessary for the FDIC to conduct the

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[4] 44 U.S.C. § 3501 *et seq.*

[5] Pub.L. 106-102, 12 U.S.C. § 4809.

[6] Pub.L. 103-325, 12 U.S.C. § 4802.

[7] Pub. L. 104-208, 12 U.S.C. § 3311.

[8] 5 U.S.C. § 801 *et seq.*

[9] FDIC Policy Statement, 63 FR 25157 (May 7, 1998).

[10] http://www.fdic.gov/regulations/laws/plans/index.html.

most effective economic analysis appropriate for specific rulemakings. In a recent evaluation of FDIC economic analysis, the FDIC Inspector General recognized the importance of flexibility in determining the most appropriate economic analysis, stating that:

> The Policy Statement is not prescriptive in terms of the analysis that must be performed in order to comply with its principles because the nature of analysis required depends on the particular rulemaking. In complying with the Policy Statement, each rulemaking team – which is comprised of subject matter experts – determines the appropriate type of analysis needed, taking into consideration any analysis prescribed by Congress and the legislative history of an authorizing statute. At other times a statute is less prescriptive, and rulemaking teams determine, based on the nature of the rule and any legislative history, the appropriate analysis to perform in order to evaluate the impact of a particular rulemaking.[11]

Attachment 3 sets forth a number of detailed examples of the kinds of analyses the FDIC undertakes in differing statutory and regulatory contexts, pointing up the need for flexibility as referred to above.

The FDIC faces certain challenges in conducting the kinds of cost-benefit analyses prescribed in OMB Circular A-4 in every rulemaking. For example, the FDIC is subject to many express statutory requirements, including some contained in the Dodd-Frank Act. The FDIC Inspector General's Report acknowledged these challenges, concluding that "[e]ach proposed rulemaking effort implements a specific Congressional mandate in the Dodd-Frank Act; thus, the FDIC's consideration of alternatives or cost and benefit factors was limited by those statutory requirements." Additional challenges are noted in the GAO report entitled, "Dodd-Frank Act Regulations: Implementation Could Benefit from Additional Analyses and Coordination."[12] For example, the FDIC faces challenges in evaluating benefits and costs due to tight time frames for issuing regulations and a lack of available data. Often, data that is available is proprietary and should not be made public during the public rulemaking process. Also, requiring data input for cost-benefit analysis could result in increasing, rather than reducing, regulatory burden for institutions that are required to submit data. The GAO report also noted that it has long been recognized that the private costs of regulation are difficult to obtain, in part because businesses have difficulty separating the costs of regulatory compliance from other costs related to risk management or recordkeeping, and measuring the benefits is a more difficult and perhaps intractable challenge, in part because regulations seeking to ensure financial stability aim to prevent low-probability, high-cost events.[13]

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[11] EVAL 11-003, entitled, **Evaluation of the FDIC's Economic Analysis of Three Rulemakings to Implement Provisions of the Dodd-Frank Act**, page 9 (June 2011)(http://www.fdicig.gov/reports11/11-003EV.pdf).

[12] GAO-12-151, Nov 10, 2011

[13] Id., at 19; GAO-08-32, at 12-13, Oct. 2007

Q2. Provide your agency's current and future plans to regularly review and, when appropriate, modify regulations to improve their effectiveness while reducing compliance burdens. Please include a description of actions your agency has taken, or plans to take, to streamline regulations; for example, the Consumer Financial Protection Bureau's "Know Before You Owe" effort drastically simplifies mortgage and student loan disclosure requirements. Also note statutory impediments, if any, that prevent your agency from streamlining any duplicative or inefficient rules under your purview.

A2: The FDIC and the other agencies that are members of the Federal Financial Institutions Examination Council (FFIEC) are required by EGRPRA to undertake a comprehensive review of their regulations at least once every ten years to identify and eliminate any outdated, unnecessary, or unduly burdensome regulations.[14] The FDIC completed its last comprehensive review in 2006 and must therefore complete the next regulatory review by 2016. In order to prepare for the next EGRPRA review process, the FDIC expects to publish for public comment in early 2012 a plan outlining the process for the FDIC's next comprehensive review of its rules.

In addition to the comprehensive regulatory review process mandated by EGRPRA, the FDIC regularly considers ways to streamline its regulations. For instance, as part of our efforts to implement the Dodd-Frank Act, the FDIC is engaged in an ongoing review of its existing rules affected by the Dodd-Frank Act. As appropriate, we will be updating, streamlining, or rescinding some of our rules to comply with and conform to the Dodd-Frank Act. Moreover, in response to input from members of the FDIC's Advisory Committee on Community Banking, we conducted a review of questionnaires and reports that banks file with us and made changes to streamline the filing process through greater use of technology and automation.

Finally, on November 10, 2011, the FDIC released a regulatory review plan that outlines a number of initiatives that the FDIC will be undertaking to review its existing rules and rulemaking process to make sure they continue to be the most effective without imposing unnecessary burdens on the industry (attached).

Q3. Provide details of how your agency encourages public participation in the rulemaking process, including through administrative procedures, public accessibility, and informal supervisory policies and procedures.

A3: The FDIC makes every effort to encourage widespread public participation in our rulemaking process. We do this by publishing Advance Notices of Proposed Rulemakings (ANPRs), Notices of Proposed Rulemakings (NPRs) and Interim Rules for public comment, including posting those documents and the comments received on our website for easy access by the public. The FDIC recognizes the importance of providing adequate time for the public comment process so we generally provide a 60-day comment period for each significant proposed rule, and for some rules we have even provided comment periods as long as 90 days. However, there may be circumstances under which

[14] Pub. L. 104-208, 12 U.S.C. § 3311.

the FDIC must propose rules with a shorter comment period, as permitted by the APA, such as when it may be necessary to meet a statutory deadline. In addition, the FDIC often puts informal supervisory guidance out for comment by all stakeholders.

In August 2010, the FDIC announced an "open door policy" that made it easier for the public to provide input and track the rulemaking process for the FDIC's implementation of the Dodd-Frank Act. The FDIC's open door policy goes beyond the notice and comment requirements of the APA governing federal agency rulemakings by providing the public the ability to play a role in the process even before specific regulations are drafted and proposed. In addition, the FDIC's policy enhances transparency and accountability in the rulemaking process through the agency's voluntary disclosure of meetings between senior FDIC officials and private sector individuals to discuss how to interpret or implement provisions of the Dodd-Frank Act that are subject to independent or joint rulemaking.

The key elements of the FDIC's open door policy include:

- The FDIC holds roundtable discussions as needed with external parties on implementation issues related to the Dodd-Frank regulatory reforms. These events are designed to provide balanced public input throughout the rulemaking process and are available for public viewing via webcasts posted to the FDIC website.
- The FDIC releases, on a regular basis, the names and affiliations of private sector individuals who meet with senior FDIC officials to discuss how the FDIC should interpret or implement provisions of the Dodd-Frank Act that are subject to independent or joint rulemaking. The FDIC also discloses the subject matter of the meetings.[15]
- To encourage public input in the process from the widest audience possible, the FDIC has created a dedicated electronic mailbox to collect input from interested parties. These comments are reviewed for content and applicability and become part of the public record posted on the FDIC website.[16]
- Consistent with its open door policy, the FDIC has provided a dedicated link on its website through which members of the public can request a meeting with FDIC staff on regulatory reform implementation issues.[17]
- The FDIC webcasts all open Board meetings, including those regarding regulatory reform, and these webcasts are made available on the FDIC website.
- Staff memoranda and draft Federal Register notices pertaining to matters considered by the FDIC's Board are routinely provided to members of the public attending open meetings and also are posted on the FDIC website—in most cases, in their entirety.[18]

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[15] *See* https://www.fdic.gov/regulations/reform/meetings.html

[16] *See* https://www.fdic.gov/regulations/laws/publiccomments/.

[17] *See* https://fdicsurvey.inquisiteasp.com/fdic.cgi-bin/qwebcorporate.dll?S3GJR6.

[18] *See* https://www.fdic.gov/regulations/laws/federal/index.html.

In addition, the FDIC has set up a subscription list allowing members of the public to sign up for a subscription service to receive email notices on major developments, and has made bill summaries and other resources on the Dodd-Frank Act available on the FDIC's dedicated financial reform webpage, http://www.fdic.gov/financialreform/.

Q4: Provide details of how your agency addresses the unique challenges facing smaller institutions when dealing with regulatory compliance, including any related advisory committees your agency may have or other opportunities for small institutions to be heard by your agency. Please also detail how your agency responds to concerns raised by small institutions.

A4: The FDIC is the primary federal supervisor for the majority of community banks in the United States. Community banks, defined as institutions with assets under $1 billion, make up nearly 7,000 of the approximately 7,500 FDIC-insured financial institutions in the country. The financial crisis and ensuing recession have taken a serious toll on community banks. Still, the large majority of community banks have come through this crisis in good shape and provide a wide range of critical services for their communities.

During the recent real estate and economic downturn, the FDIC has advocated policies that help community banks navigate these challenging times and comply with new laws and regulations. Through our regional and field offices, the FDIC actively communicates with the community banks we supervise and provides recommendations for addressing financial and regulatory compliance issues. The FDIC benefits from a cooperative relationship with the community banking sector through engagement with individual institutions and, at the state and national levels, through dialogue with industry trade groups.

Given the importance of community banking to the national and local economies, as well as to the financial services sector, in 2009 the FDIC established an Advisory Committee on Community Banking. The Advisory Committee comprises representatives from community banks and academia and provides the FDIC with an informed perspective on the challenges small banks face. The FDIC leverages the Advisory Committee's knowledge and experience to obtain input on banking policy, refine our supervisory programs, and address unnecessary regulatory burden. The Advisory Committee has provided valuable input on credit conditions, regulatory compliance matters, and community banks' ability to remain competitive in the financial services marketplace.

In addition, the FDIC sponsors training events for community banks, including regional and national teleconferences on risk management and consumer protection matters, and Directors Colleges to help bank directors better understand new regulations and the supervisory process.

As the primary federal regulator for the vast majority of the community banks, the FDIC is sensitive to their resource constraints and we have taken steps to streamline oversight and strengthen communication with these institutions. In 2011, we instituted an internal process that considers, prior to issuance, the anticipated impact of any new FDIC

directive or guidance on small banks. This process helps smaller institutions gauge the effect of new supervisory expectations and provides an internal reasonableness check. We also continue to assess community banks' resource capabilities when updating the Consolidated Reports of Condition and Income (Call Reports) and have made appropriate adjustments. For example, on November 21, 2011, the FDIC, the Office of the Comptroller of the Currency, and the Board of Governors of the Federal Reserve System published a Federal Register notice seeking public comment on proposed Call Report changes for 2012.[19] Proposed changes to be effective with the June 30, 2012 Call Report are focused primarily on institutions with total assets of $1 billion or more. We also have initiated the practice that, in connection with the issuance of any new Financial Institution Letters (or FILs), there is a statement near the beginning indicating the impact (if any) on insured institutions with less than $1 billion in assets – enabling smaller institutions to easily identify any FILs that are not relevant to smaller entities.

A focus on community banks will be a major priority for the FDIC over the coming year. The FDIC has developed a set of community banking initiatives to further its dialogue with the industry and better our understanding of the challenges and opportunities for community banks. First, we will host a national conference in February 2012 to kick off this effort that will focus on the future of community banks, their unique role in supporting our nation's economy, and the challenges and opportunities that they face in this difficult economic environment. Following the conference, the FDIC will hold a series of roundtable discussions with community bankers in each of the FDIC's six regional offices around the country in which senior FDIC executives, including the Chairman, will participate.

In addition, we are undertaking a major research initiative to examine a variety of issues related to community banks, including their evolution, characteristics, performance, challenges, and role in supporting local communities. The FDIC's research agenda will cover topics such as changes in community bank size and geographic concentration over time, measuring the performance of community banks, and changes in business models and cost structures. The research also will look at how trends in technology and the small business economy have affected community banks and the lessons for community banks from the current crisis.

Also as part of these initiatives, the FDIC is continuing to look for ways to improve the effectiveness of its examination and rulemaking processes. We are seeking to identify supervisory improvements and efficiencies that can be made while maintaining our supervisory standards. For example, the FDIC is exploring enhancements to our offsite reviews, pre-examination planning processes, information requests, and examination coordination. In addition we are exploring communications strategies to update the industry on upcoming guidance and rulemakings that affect FDIC-supervised community banks in an organized and understandable way so that institutions can more effectively plan to meet their compliance obligations. The FDIC continues to ensure that

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[19] *See* http://www.ffiec.gov/pdf/FFIEC_forms/FFIEC031_FFIEC041_20111121_ifr.pdf

examination guidance takes into account the size, complexity and risk profile of each institution. The FDIC now includes an up-front section in each Financial Institution Letter sent to insured depository institutions that describes its applicability to institutions with total assets of less than $1 billion.

With regard to our efforts to respond to smaller institutions' concerns with the examination process, the FDIC follows an open, two-way communication process. The FDIC considers bankers' comments about our conclusions in the shared interest of accurately assessing an institution's risk profile, understanding its strategic goals, and serving the local community. We conduct, on average, more than 4,350 on-site safety and soundness, compliance, and Community Reinvestment Act (CRA) examinations annually (approximately 54 percent of FDIC-supervised institutions are examined each year for safety and soundness and 40 percent are examined for compliance and CRA), and recognize that questions about and even disagreements with our findings may sometimes arise, especially in difficult economic times. The FDIC has a number of informal and formal outlets for bankers to express their concerns when this occurs. When banks disagree or are uncomfortable with examination findings, they are advised to discuss such concerns with us; however, they also can appeal supervisory determinations through a formal process, which culminates with a review by the Supervision Appeals Review Committee chaired by an FDIC Board member, or seek the impartial assistance of the FDIC's Office of the Ombudsman. In addition, bankers have an opportunity after each examination to submit an anonymous survey (or they can identify themselves and request specific follow-up by FDIC staff) about their experiences to the agency. The FDIC welcomes feedback from the industry and relies on bankers' informed perspectives as we consider refinements to our supervisory process.

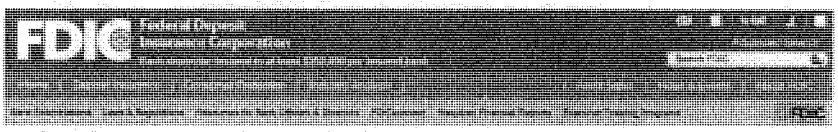
Q5: Describe how regulatory interagency coordination has improved since the creation of the Financial Stability Oversight Council established by the Wall Street Reform Act. Provide specifics of how coordination has helped, either formally or informally, in your rulemaking process.

A5: The FDIC has a long history of coordinating with our fellow banking regulators in our rulemaking process by virtue of the makeup of our Board of Directors, which includes heads of other banking agencies, as well as through the FFIEC and other less formal consultative efforts. Moreover, many statutorily-required rulemakings are joint or interagency efforts. The Financial Stability Oversight Council (FSOC) has strengthened and broadened previous coordinating relationships by increasing the scope of activities and regulators who are required to coordinate and consult and by providing a forum and procedures to execute such coordination.

Moreover, the FSOC has provided a useful means for agencies to facilitate communication on rulemakings required by the Dodd-Frank Act. For example, the FSOC facilitated coordination on the joint FDIC/Treasury rule on Maximum Obligation Limitation (MOL) required by the Dodd-Frank Act. In that case, the FDIC and Treasury consulted with the other FSOC-member agencies before issuing the proposed rule.

The FDIC believes that additional interagency communication on significant Dodd-Frank Act rulemakings is useful even when consultation or coordination is not statutorily required. The FDIC intends to work with the other FSOC member agencies to enhance communication and coordination efforts.

Attachment 1



FDIC Law, Regulations, Related Acts

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5000 - Statements of Policy

DEVELOPMENT AND REVIEW OF FDIC REGULATIONS AND POLICIES

Statement of Policy

Purpose and Scope. The Federal Deposit Insurance Corporation is committed to continually improving the quality of its regulations and policies, to minimizing regulatory burdens on the public and the banking industry, and generally to ensuring that its regulations and policies achieve legislative goals effectively and efficiently. The purpose of this statement of policy (Policy) is to establish basic principles which guide the FDIC's promulgation and review of regulations and written statements of policy. The scope of this Policy is limited to regulations and written statements of policy issued by the Board of Directors of the FDIC.

Principles For the Development and Review of Regulations and Statements of Policy. The following principles guide the FDIC in its development of regulations and written policies:

• Burdens imposed on the banking industry and the public should be minimized. Before issuing a regulation or written statement of policy the FDIC gives careful consideration to the need for such an issuance. Frequently a regulation is required by statute. Alternatively, the FDIC may identify a need for a supervisory tool to implement its statutory obligations, or to clarify its policy for the benefit of the banking industry or the public. Once the need for a regulation or statement of policy is determined, the FDIC seeks to minimize to the extent practicable the burdens which such issuance imposes on the banking industry and the public. New reporting and recordkeeping requirements imposed by a regulation are carefully analyzed. The effect of the regulation or statement of policy on competition within the industry is considered. Particular attention is focused on the impact that a regulation will have on small institutions and whether there are alternatives to accomplish the FDIC's goal which would minimize any burden on small institutions. Prior to issuance, the potential benefits associated with the regulation or statement of policy are weighed against the potential costs.

• Regulations and policies should be clearly and understandably written. The Board seeks to make its regulations and statements of policy as clear and as understandable as possible to those persons who are affected by them. In developing or reviewing existing regulations and statements of policy, the Board considers the document's organizational structure as well as the specific language used; both are important components to achieving a clear and useful statement.

• The public should have a meaningful opportunity to participate in the rulemaking process. The Board seeks to improve its regulations and statement of policy during the development phase. Whether a new regulation is being promulgated or an existing one revised, the Board gives careful consideration to the implications of its actions as public policy. Public participation in the rulemaking process is an opportunity for the Board to hear directly from affected members of the public with important experience and thoughtful insights related to the pertinent issues. A person or organization may petition the Board for the issuance, amendment, or repeal of any regulation or policy by submitting a written petition to the Executive Secretary of the FDIC. The petition should

include a complete and concise statement of the petitioner's interest in the subject matter and the reasons why the petition should be granted.

All rulemaking is carried out in accordance with the APA, by which the Board provides the public with notices of proposed rulemaking and opportunities to submit comments on the proposals. The Board will often seek public comment on proposed statements of policy as well. All comments and proposed alternatives received during the comment period are considered prior to the issuance of a final rule or statement of policy. The Board takes final action on proposed regulations and policies as promptly as circumstances allow. If a significant period of time elapses following the publication of a proposed rule or policy without final action, the Board will consider withdrawing the proposal or republishing it for comment. If the Board decides to reconsider a proposed regulation or statement of policy that has been withdrawn, it will begin the rulemaking or policy development process anew.

• Common statutory and supervisory requirements should be implemented by the Federal financial institutions regulators in a uniform way. The FDIC has many statutory and supervisory requirements that are common to the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and/or the National Credit Union Administration. The more uniform the Federal financial institutions regulators can be in their regulations, policies and approaches to supervision, the easier it will be for the industry and the public to comply with the regulators' requirements. The FDIC is a member of the Federal Financial Institutions Examination Council (FFIEC) and works with the other federal financial institutions regulators through the FFIEC to make uniform those regulations and policies that implement common statutory or supervisory policies.

• Regulations and statements of policy should be reviewed periodically. To ensure that the FDIC's regulations and written statements of policy are current, effective, efficient and continue to meet the principles set forth in this Policy, the FDIC will periodically undertake a review of each regulation and statement of policy. The Executive Secretary of the FDIC will, consistent with applicable laws and in coordination with other financial institutions regulators, establish a schedule and procedures for the reviews. Factors to be considered in determining whether a regulation or written policy should be revised or eliminated include: the continued need for the regulation or policy; opportunities to simplify or clarify the regulation or policy; the need to eliminate duplicative and inconsistent regulations and policies; and the extent to which technology, economic conditions, and other factors have changed in the area affected by the regulation or policy. The result of this review will be a specific decision for each regulation and statement of policy to either revise, rescind or retain the issuance in its then-current form. The principles of regulation and statement of policy development, as articulated at the beginning of this Policy, will apply to the periodic reviews as well.

By order of the Board of Directors, April 28, 1998.

[Source: 63 Fed. Reg. 25157, May 7, 1998]

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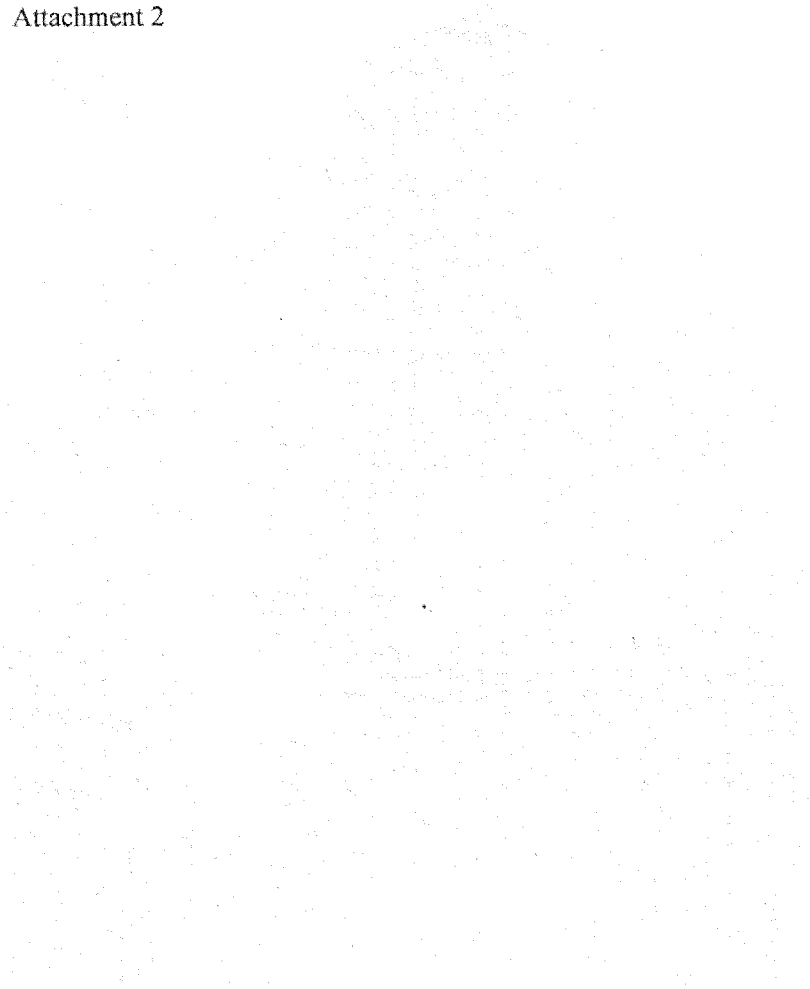
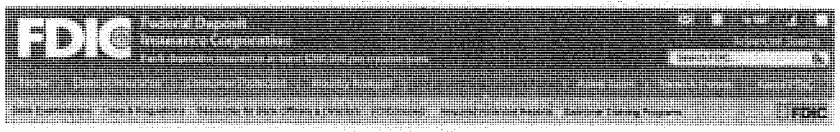
Attachment 2





FDIC's Plans to Review Existing Regulations for Continued Effectiveness

On July 11, 2011, the President issued Executive Order 13579, "Regulation and Independent Regulatory Agencies". The FDIC has a long-standing policy and practice of reviewing its proposed and existing regulations to evaluate their impact. Following is an overview of the FDIC's plans to review existing regulations for effectiveness.

FDIC's Statement of Policy on Rulemaking

The FDIC has a longstanding policy of implementing its regulations in the least-burdensome manner possible, in accordance with the *FDIC Statement of Policy on the Development and Review of FDIC Regulations and Policies*, 63 Fed. Reg. 25,157 (1998). That Statement of Policy recognizes the FDIC's commitment to minimizing regulatory burdens on the public and the banking industry and the need to ensure that FDIC regulations and policies achieve regulatory goals effectively. The Statement of Policy also provides that the FDIC will periodically review its regulations and statements of policy to ensure that they are current, effective, efficient, and continue to meet principles of the Statement of Policy. The FDIC will be undertaking a review of the 1998 Statement of Policy itself to determine how it should be revised to incorporate additional principles regarding cost-benefit analysis, and otherwise to serve the purpose of reducing regulatory burden.

In addition to this longstanding policy, the FDIC will be undertaking a number of initiatives to review its existing rulemaking process.

Review and Update Rules Affected by the Dodd-Frank Act

As part of its implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), the FDIC is also engaged in an ongoing review of its rules affected by the Dodd-Frank Act. We are updating, streamlining, or rescinding some of our rules to comply with and conform to the Act. We are also working to establish clear rules that will ensure a stable financial system and impose minimum regulatory burden. In all Dodd-Frank Act rulemakings, we have been coordinating our efforts closely with the other financial regulators to ensure consistency and avoid duplication of efforts. We also invite public participation in each phase of the rulemaking process. The FDIC plans to continue those efforts.

Evaluation of Examinations and Rulemakings Affecting Community Banks

The FDIC is undertaking a community bank initiative in which the FDIC will review both its examination process and rulemaking process to further our understanding of the challenges and opportunities for community banks. We plan to hold a conference early in 2012 on the future of community banking and are tracing the evolution of community banks over the past 20 years, including changes in business models and cost structures, so that we can suggest lessons to be learned. The FDIC is also reviewing key challenges facing community banks, such as raising capital, keeping up with technology, attracting qualified personnel, and meeting regulatory obligations. Additionally, we are evaluating our own risk-management and compliance supervision practices to see if there are ways to make the process more efficient. We will continue to have direct outreach and an open dialogue by holding a series of regional roundtables with community bankers across the country to get their input on these and other matters. The FDIC will further this dialogue through public meetings of our Advisory Committee on

Community Banking, a forum where we hear firsthand from a broad cross-section of community bankers about both the challenges and the opportunities they see in their markets, as well as some of the concerns they have about the regulatory environment. This overall effort in regard to community banks will be a major priority for the FDIC during 2012.

Streamlining and Transparency

The FDIC has already taken steps to reduce burden and increase transparency in rulemaking. In response to input from members of the FDIC's Advisory Committee on Community Banking on ways to reduce regulatory burden, we conducted a review during 2011 of the questionnaires and reports that banks file with us and made changes to streamline the filing process through greater use of technology and automation. Also, to make it easier for smaller institutions to understand the impact of new regulatory changes or guidance, we specifically added a statement up front in our Financial Institution Letters (the vehicle used to alert banks to any regulatory changes or guidance) as to whether the change applies to institutions under $1 billion.

The FDIC has also put in place a number of measures to promote transparency in our rulemaking process, including holding public roundtable discussions on Dodd-Frank implementation issues via webcast, releasing the names and affiliations of private sector individuals who meet with senior FDIC officials to discuss matters subject to rulemaking under the Dodd-Frank Act; establishing a dedicated mailbox to collect and post on the FDIC's website input from the public; and hosting a dedicated webpage that provides information on the Dodd-Frank Act implementation process at the FDIC.

Continued Analysis of the Costs and Benefits of Rulemaking

In its general rulemaking process, the FDIC continually focuses on the potential costs and benefits of the rules that it adopts. A number of statutes help ensure that regulatory agencies consider and minimize regulatory burdens. For example, under the Regulatory Flexibility Act, the Riegle Community Development and Regulatory Improvement Act, and the Small Business Regulatory Enforcement Fairness Act, the FDIC must analyze a proposed rule's impact on depository institutions, customers of depository institutions, small depository institutions, and industry competition. The FDIC considers the effect of its regulations on competition within the industry and specifically analyzes effects on banks and their ability to raise capital. These analyses are an important way in which the FDIC strives to ensure that its rules meet statutory rulewriting requirements in the most efficient manner possible.

Many of the FDIC's regulations are required by statute and/or are aimed at protecting the Deposit Insurance Fund. It is the FDIC's longstanding policy to ensure that the rules it adopts are the least burdensome to achieve those goals. The FDIC's Statement of Policy recognizes our commitment to minimizing regulatory burdens on the public and the banking industry and the need to ensure that our regulations and policies achieve regulatory goals effectively.

A recent Inspector General's report (which can be found online at http://www.fdicig.gov/reports11/11-003EV.pdf) (PDF Help) examined three FDIC rulemaking projects. The Inspector General's findings confirmed that the FDIC staff worked with other financial regulatory agencies to ensure a coordinated rulemaking effort; performed quantitative analysis of relevant data; considered alternative approaches to the rules; and, where applicable, included information about the analysis that was conducted and assumptions that were used in the text of the proposed rule. The report also found that each of the proposed rules examined by the Inspector General was considered by the FDIC Board of Directors in open, public meetings.

Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA)

Finally and importantly, the FDIC will be undertaking a comprehensive

review of its regulations in order to identify any outdated, unnecessary or unduly burdensome regulations pursuant to the EGRPRA. This well-established process requires the FDIC to conduct a complete review of all its regulations at least every ten years. The FDIC completed its last review under EGRPRA in 2006 and must complete its next comprehensive review by the year 2016. In order to prepare for the upcoming EGRPRA review process, the FDIC will publish for public comment in early 2012 a plan outlining the process for the FDIC's next comprehensive review of its rules.

Last Updated 11/15/2011

Attachment 3 - Examples of the kinds of analyses the FDIC undertakes

In setting assessments, the FDIC considers specific factors required by statute:

In administering the risk-based deposit insurance assessment system, the FDIC must comply with certain express statutory requirements. For example, Section 7 of the Federal Deposit Insurance Act (the FDI Act) directs the FDIC to create a risk-based assessment system, taking into consideration the probability that the Deposit Insurance Fund (DIF) will incur a loss with respect to an institution, and taking into consideration the institution's categories and concentrations of assets and liabilities, any other relevant factors, the amount of loss, and the revenue needs of the DIF.[1] Section 7 authorizes the FDIC to set assessments in such amounts as it determines to be necessary or appropriate, and in doing so the FDIC must consider enumerated factors, including the estimated case resolution expenses and income of the DIF and the projected effects of assessments on the capital and earnings of insured depository institutions.[2]

With respect to the size of the Deposit Insurance Fund, statutory requirements represent a congressional balancing of benefits and costs:

The FDIC also is subject to requirements contained in the Dodd-Frank Act. Under the Dodd-Frank Act, Congress required that the FDIC take steps to assure that the DIF reserve ratio reaches 1.35 percent by September 30, 2020. This statutory requirement represents a congressional balancing of benefits and costs, ensuring that the DIF will have sufficient resources within a reasonable amount of time without imposing extremely high deposit insurance assessments on a banking industry trying to recover from a severe downturn. Given the actual and projected losses to the DIF resulting from the current financial crisis, this requirement creates specific revenue needs for the DIF that the FDIC must meet.

The Dodd-Frank Act also required the FDIC to amend its regulations to redefine the assessment base used for calculating deposit insurance assessments as average consolidated total assets minus average tangible equity (with some possible exceptions). During the rulemaking process, the FDIC considered costs to the industry and economy.

Quantitative and qualitative analysis undertaken for the assessment rules:

The FDIC conducted economic analysis during the rulemaking process on the assessment base, assessment rates, and large bank pricing consistent with the broad principles guiding economic analysis of the executive orders and OMB Circular A-4. The FDIC determined the most appropriate and effective type of analysis needed to evaluate the impact of the rulemaking on the industry and the public. Specifically, the FDIC undertook extensive analysis consistent with its Policy Statement and statutory requirements to ensure that the revised assessment system would create the necessary revenue stream to meet statutorily mandated goals without imposing unnecessary

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[1] 12 U.S.C. §1817(b)(1)(C)

[2] 12 U.S.C. §1817(b)(2)(B)

additional cost. In addition, the FDIC updates its long-term loss, income, and DIF reserve ratio projections every six months to determine the appropriate assessment rates and revenue needed to comply with the statute and to ensure that it remains on track to restore the DIF reserve ratio within the statutory deadline. By definition, this analysis considered possible future benefits and costs. In the Final Rule on Assessments and Large Bank Pricing, the FDIC sought to maximize the benefits to the industry and the economy relative to potential costs of inappropriately assessing risk or not building the fund balance high enough. Using the loss, income, and DIF reserve ratio projections, the FDIC examined many different alternative assessment rate schedules to determine one that would maintain the revenue needed and meet other statutory requirements (*e.g.*, the FDI Act requirement that the assessment system be risk based), without either materially increasing or decreasing overall assessment costs for the banking industry.

In revising the assessment system, the FDIC also considered the benefits of improved risk pricing for large and highly complex institutions. These benefits are quantified using the regression model available in Appendix 2 of the Final Rule, which estimates how well the revised risk measures would have predicted the expert judgment ranking of institutions when applied from 2005 through 2008. The FDIC also tested other methodologies and the inclusion of other risk measures in the scorecards used to determine the assessment rate for large and highly complex institutions and found that these alternative approaches had weaker predictive ability. The statistical analysis produced quantifiable results that weigh the costs and benefits of alternative approaches. Further, during its analysis the FDIC considered including additional metrics in the scorecard that may have improved the predictive ability of the scorecard; however, these metrics were not included due to the potential burden on the industry. While this analysis did not expressly "monetize" the benefit, it did include a significant cost-benefit analysis that is relevant for the statutory criteria being analyzed.[3]

During the rulemaking process, the FDIC also considered certain costs of revising risk pricing. For example, the FDIC responded to industry comments by implementing modifications to definitions that affect certain items on the scorecard. These modifications reduce the cost to the industry of recurring data collection related to the scorecard items. Following the adoption of the final rule, the FDIC received further comments voicing concern about operational obstacles to implementing other definitions on the scorecard. In light of those comments, the FDIC delayed the implementation of those definitions in order to explore options for addressing those problems.

As required by the FDI Act, the FDIC analyzed the effect of its assessment proposal on the capital and earnings of the industry. While this analysis did not expressly "monetize" the cost, it did include a significant cost analysis that is relevant for the statutory criteria being analyzed.[4]

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[3] The analysis found that all of the measures are statistically significant in explaining the expert judgment ranking of institutions at the 5 percent or 1 percent level in several years. All of the estimated coefficients have a positive sign, which is consistent with expectations since each measure was normalized into a score that increases with risk.

[4] The analysis found that projected decreases in assessments would prevent three institutions from becoming under-capitalized (*i.e.*, from falling below four percent equity to assets) that were projected to do

The FDIC also undertook extensive analysis to ensure that the assessment revenue generated by large banks overall under the Large Bank Pricing rule was proportional to the large banks' overall share of the assessment base to be consistent with congressional intent.

Any additional analysis of the costs and benefits of the rule would have required data and resources beyond those available to the FDIC, particularly given the need for timely action. Congress intended that the change in the assessment base shift the assessment burden from smaller to larger insured financial institutions. Given this intent, delay in adopting the rules necessary to implement the new assessment base would, in the FDIC's view, have been unwarranted.[5] Furthermore, given the statutory directive and intent of Congress, it is not clear how additional cost-benefit analysis would have changed the rule adopted on the assessment base.

OMB guidance recommends "monetizing" the costs and benefits for each of the alternatives considered. In the context of the large bank pricing rule, it is not clear how monetizing benefits would have altered the final rule. Congress has mandated a risk-based system and the FDIC's analysis showed that the proposed system significantly improved risk differentiation. The FDIC evaluated other reasonable alternatives to the structure of the large bank pricing rule, and proposed the approach that was most supported by a comprehensive, statistically based analysis.

Quantitative and qualitative analysis undertaken for the Designated Reserve Ratio rule

The FDIC conducted economic analysis during the rulemaking process for setting the DRR consistent with the broad principles guiding economic analysis of the executive orders and OMB Circular A-4. When setting the DRR, the FDIC is required by statute to consider past, current and future risk of loss to the DIF, economic conditions affecting insured depository institutions, measures to prevent sharp swings in assessment rates, and other factors the FDIC deems appropriate.[6] The Proposed Rule addressing Assessments, Large Bank Pricing, and the Designated Reserve Ratio contemplated alternative DRRs and their impact on the fund, dividend policy, and premium volatility.

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so otherwise. Lower assessments would also prevent one institution from declining below two percent equity to assets that would have otherwise. No bank facing an increase in assessments would, as a result of the assessment increase, fall below the four percent or two percent thresholds. The analysis also found that approximately 84 percent of profitable institutions (whose assets total nearly $5 billion) were projected to have a decrease in assessments in an amount between zero and ten percent of income, while only one percent of institutions (whose assets total approximately $5.4 billion) would face assessment increases between zero and ten percent of their income.

[5] *See, e.g.*, Statements of Senator Hutchison, 156 Cong. Rec. S3154 (May 5, 2010) (Co- Sponsor of Amendment No. 3749, which contains the new assessment base) and 156 Cong. Rec. S3297 (May 6, 2010). Similar arguments in favor of the amendment were made by co-sponsor Senators Tester, Johanns, and Brown. Statements of Senator Tester, Senator Johanns, and Senator Brown, 156 Cong. Rec. S3296, S3297, S3298 (May 6, 2010).

[6] 12 U.S.C. §1817(b)(3)(C).

Analysis conducted for the rule considered potential benefits and costs to the industry and to the public, including the impact on banks and on financial stability. In particular, the analysis quantified the cost to the banking industry in terms of assessment rates and premium volatility. For example, the analysis showed that under one alternative DRR and dividend policy, banks would have to pay assessment rates nearly five times higher during crisis years than non-crisis years.[7] The analysis also considered the benefits of a DRR that could be accompanied by more stable, predictable assessment rates and could maintain public confidence in the fund, although these benefits probably cannot be quantified.

Any additional analysis of the costs and benefits of the rule would have required data and resources beyond those available to the FDIC, particularly given the statutory deadline that a DRR must be set for each year. It is not apparent to the FDIC that attempts to monetize or quantify benefits would have added materially to the extensive analysis already conducted during the rulemaking or have changed the final rule.

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[7] This conclusion, based upon analysis undertaken in connection with the rulemaking, is reflected in *Toward a Long-Term Strategy for Deposit Insurance Fund Management*, FDIC Quarterly, Vol. 4, No. 4, 2010.

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

December 5, 2011

The Honorable Tim Johnson
Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Johnson:

Thank you for your November 9, 2011 letter regarding the implementation by the Office of the Comptroller of the Currency (OCC) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). We appreciate the opportunity to respond and share with you information concerning our regulatory work, which currently includes a comprehensive review of all national bank and Federal savings association regulations with a view toward streamlining and reducing unnecessary burden, as well as other regulatory projects to implement specific provisions of the Dodd-Frank Act. Detailed answers to your questions are set forth in the attachment that follows.

If you have further questions or need additional information, please contact me or Robert Garsson, Deputy Comptroller for Public Affairs, at 202-874-4880.

Sincerely,

John Walsh
Acting Comptroller of the Currency

Enclosures:

1. Guide to OCC Rulemaking Procedures

2. Letter dated November 29, 2011, from John Walsh, Acting Comptroller of the Currency, to Cass Sunstein, Administrator, Office of Information and Regulatory Affairs, Office of Management and Budget

December 5, 2011

OCC Responses to Questions from Chairman Johnson

1. *Provide a detailed description of your agency's rulemaking process, including the variety of economic impact factors considered in your rulemaking. Please note to what degree you consider the benefits from your rulemaking, including providing certainty to the marketplace and preventing catastrophic costs from a financial crisis. Also describe any difficulties you may have in quantifying benefits and costs, as well as any challenges you may face in collecting the data necessary to conduct economic analysis of your rulemaking.*

The OCC takes seriously the need to understand how its rules affect the public and private sectors and the economy as a whole. As part of this effort, the OCC conducts several types of economic impact assessments for all proposed and final rules. This includes any analysis required by the Unfunded Mandates Reform Act (UMRA), the Congressional Review Act (CRA), and the Regulatory Flexibility Act (RFA).[1] Specifically, under UMRA, the OCC assesses whether a proposed or final rule includes a "Federal mandate" that may result in the expenditure by state, local, or tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year (adjusted for inflation). If this threshold is met, the OCC prepares a more detailed economic assessment of the rule's anticipated costs and benefits. Under the CRA, the OCC determines, among other things, whether a final rule is likely to result in a $100 million or more annual effect on the economy. Under the RFA, the OCC determines if a proposed or final rule is likely to have a "significant economic impact on a substantial number of small entities."

In preparing cost-benefit studies, the OCC refers to the Office of Management and Budget's Circular A-4. This document provides guidance to Federal agencies on the development of regulatory analyses under Executive Order 12866 and, although the OCC is not subject to this Executive Order, we use Circular A-4 as a best practices guide in preparing our analyses. These analyses typically include an assessment of a rule's benefits, along with cost-benefit comparisons of scenarios in which the rule does not apply and those in which one or more plausible alternatives to the rule apply.

In order to assess costs and benefits, the OCC examines data from national bank Quarterly Reports of Condition and Income (Call Reports) or Thrift Financial Reports (TFRs).[2] It also estimates costs or benefits that are likely to result from complying with the rule, including those that affect the amount of regulatory capital an institution must hold. In addition, the OCC considers broader economic factors such as the potential impact of the rule on lending, domestic and international competition, and economic growth.

The costs associated with a rule can be difficult to quantify with precision, as are some types of benefits. In particular, some benefits are qualitative in nature and inherently difficult to quantify. For example, a new rule might reduce the impact of moral hazard or require additional financial

[1] UMRA: 2 U.S.C. 1501 *et seq.*; CRA: 5 U.S.C 801 *et seq.*; and RFA: 5 U.S.C. 601 *et seq.*

[2] In 2012, TFRs will be eliminated and all national banks and Federal thrifts will file Call Reports

disclosures that enhance market discipline. Other rules may provide predictability to the marketplace and thereby enhance its stability. In these situations, the OCC enumerates the qualitative benefits in its analysis but does not attribute to them a specific dollar value.

One challenge the OCC faces is collecting data where a rule affects balance sheet or income statement items that are not captured in Call Reports or TFRs. In these cases, the OCC may consider data from credible industry or media reports and academic literature and consult with OCC subject matter experts. The OCC also considers any public comments it receives that present cost-benefit information. Through the appropriate use of these various data sources, the OCC is able to perform the required economic assessment.

The OCC recently revised its Guide to OCC Rulemaking Procedures, which contains a detailed and comprehensive description of its entire rulemaking process. Among other things, the Guide describes the various steps the OCC takes at each point in the rulemaking process and seeks to ensure that the OCC complies with rulemaking requirements imposed by relevant statutes and Executive Orders. It also promotes the integrity of the OCC's rulemaking process by ensuring accountability and appropriate documentation of decision-making. We are including a copy of the Guide with this letter.

2. *Provide your agency's current and future plans to regularly review and, when appropriate, modify regulations to improve their effectiveness while reducing compliance burdens. Please include a description of actions your agency has taken, or plans to take, to streamline regulations - for example, the CFPB's "Know Before You Owe" effort drastically simplifies mortgage and student loan disclosure requirements. Also note statutory impediments, if any, that prevent your agency from streamlining any duplicative or inefficient rules under your purview.*

Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) transferred to the OCC all the functions of the Office of Thrift Supervision (OTS) and the Director of the OTS related to Federal saving associations, as well as OTS rulemaking authority related to both state and Federal savings associations. In connection with this transfer, the OCC has undertaken a comprehensive review of national bank and Federal thrift regulations to make them more effective by combining them where possible, reducing duplication, and eliminating unnecessary requirements. As part of this review, we have committed to seek public comment about ways to improve each rule as we prepare the final, integrated rulebook. In addition, the OCC is subject to a decennial regulatory review requirement unique to the Federal banking agencies, pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA).[3] The OCC and the other banking agencies completed the last EGRPRA review over a period that ended December 2006, and, as the statute requires, we will complete the next EGRPRA review not later than 2016.

The OCC recently sent a letter to Mr. Cass Sunstein, Administrator of the Office of Information and Regulatory Affairs, Office of Management and Budget, providing additional information about the OCC's efforts to increase regulatory effectiveness and reduce regulatory burden. A copy of that letter is included as part of this response.

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[3] 12 U.S.C. 3311.

3. *Provide details of how your agency encourages public participation in the rulemaking process, including through administrative procedures, public accessibility, and informal supervisory policies and procedures.*

The OCC encourages the public to participate in the rulemaking process through its compliance with the Administrative Procedure Act (APA)[4] and its use of various forms of media to make the public aware of its rulemaking initiatives. Consistent with the APA, the OCC publishes for comment in the *Federal Register* a notice of each proposed rulemaking (NPR). Each NPR is accompanied by a news release intended to increase awareness of the proposed rule and comment process. In addition to being distributed to reporters and media outlets, these news releases are posted to the OCC's web site and featured on its home page (www.occ.gov). In addition, every news release is distributed to the nearly 13,000 subscribers to our e-mail subscription service. Each news release is also distributed via Twitter and the OCC's official Facebook page and through OCC syndicated news feeds.

For each NPR, the OCC generally provides the public with at least a 60 day comment period and details the numerous channels through which comments can be submitted, including by hard copy or electronically, either to the OCC's web site or through the Federal government's e-rulemaking portal. The OCC solicits comments on a wide variety of issues raised by each proposal, including on any regulatory burden associated with a proposal. The agency values all public feedback and carefully considers all the comments it receives as it formulates a final rule.

In addition, the OCC has, from time to time, issued an Advance Notice of Proposed Rulemaking (ANPR) to invite public comment in advance of formulating a proposed rulemaking. An ANPR can be helpful to the OCC in obtaining information from interested parties relevant to a potential rulemaking and can assist the OCC in understanding different perspectives on a matter that is likely to be the subject of a future rulemaking.

The OCC is also carrying on the work of two advisory committees established by the OTS: the Mutual Savings Association Advisory Committee (MSAAC) and the Minority Depository Institutions Advisory Committee (MDIAC). These committees will provide the OCC with insight into the unique challenges facing these groups so that these concerns can be factored into the rulemakings that will affect them.

4. *Provide details of how your agency addresses the unique challenges facing smaller institutions when dealing with regulatory compliance, including any related advisory committees your agency may have or other opportunities for small institutions to be heard by your agency. Please also detail how your agency responds to concerns raised by small institutions.*

As part of its rulemaking process, the OCC carefully considers concerns raised by small institutions in a number of ways. The RFA generally requires the OCC to review proposed regulations for their impact on small entities and, in certain cases, to consider less burdensome alternatives. After conducting this review, the OCC is required either to prepare an Initial

[4] 5 U.S.C. 551 *et seq.*

Regulatory Flexibility Analysis or to certify that the proposed rule will not have a "significant economic impact on a substantial number of small entities." The OCC follows similar procedures when promulgating a final rule.

The OCC's organizational structure also distinguishes between the supervision of small and large institutions, which allows the OCC to focus on the unique challenges facing community institutions. For example, the OCC's Community Bank Supervision program, which is managed separately from its Large Bank Supervision program, is built around its local field offices, with approximately 75% of OCC examination staff dedicated to supervising these community institutions. These examiners are based in over 60 cities throughout the United States in close proximity to the banks they supervise.

The primary responsibility for the supervision of individual community banks is delegated to the local Assistant Deputy Comptroller (ADC). This structure ensures that community banks receive the benefits of highly trained bank examiners with local knowledge and experience, along with the resources and specialized expertise that a nationwide organization can provide. While OCC bank supervision policies and procedures establish a common framework and set of expectations, examiners are taught to tailor the supervision of each community bank to its individual risk profile, business model and management strategies. As a result, the OCC's ADCs are given considerable decision-making authority, reflecting their experience, expertise and "on the ground" knowledge of the institutions they supervise.

The OCC recognizes the importance of communicating regularly with community banks outside of the supervision process, in order to clarify its expectations for smaller institutions, discuss emerging issues of interest to community bankers, and respond to their concerns. The OCC participates in numerous industry-sponsored events and hosts a variety of outreach activities, such as Meet the Comptroller events, the Washington Visits program, chief executive officer roundtables, and teleconferences on topical issues. These events provide many opportunities for constructive exchanges at the national and local level. In addition, as noted above, the OCC is carrying on the work of the MSAAC and the MDIAC, which will provide formal mechanisms for the OCC to hear the concerns particular to these subsets of the smaller institutions we regulate.

5. *Describe how regulatory interagency coordination has improved since the creation of the FSOC. Provide specifics of how coordination has helped, either formally or informally, in your rulemaking process.*

The OCC and the other Federal banking agencies have a history of coordination in issuing regulations and guidance. In many instances, Congress has required the agencies to conduct these activities jointly; in others, the agencies have recognized that it is appropriate to do so to avoid inequities and opportunities for regulatory arbitrage. The FSOC provides a broader forum for coordination and the sharing of information among all the U.S. financial institution regulatory agencies. The relationships among the regulators that the FSOC has established facilitate more informal coordination and consultation as agencies work on the many rulemakings that the agencies individually and jointly must undertake to implement Dodd-Frank.

For example, OCC staff members – ranging from senior deputy comptrollers to staff members – are in frequent contact with their counterparts at the other banking agencies and, increasingly, with the other financial sector regulators with whom they share implementation responsibilities for the Dodd-Frank Act. These less formal interactions provide multiple channels for facilitating consistent and comparable regulations, as appropriate in light of the structure and activities of the institutions under the agencies' respective jurisdictions.

Moreover, in certain instances – with respect to the Dodd-Frank Act's Volcker Rule and the rule on credit risk retention, both of which are to be implemented by multiple agencies – the statute assigns the Secretary of the Treasury, in his capacity as Chairperson of the FSOC, responsibility for coordinating the issuance of interagency regulations. The agencies' proposal to implement the Volcker Rule, published in October of this year, was issued jointly by all but one of the participating agencies. The proposed rule on credit risk retention was issued jointly by all the agencies that have implementation responsibilities for that statutory provision, even though joint action by all of the participating agencies on each element of the statute was not required.

GUIDE TO OCC RULEMAKING PROCEDURES

A STAFF MANUAL

OFFICE OF THE COMPTROLLER OF THE CURRENCY
DECEMBER 1, 2011

Table of Contents

A STAFF MANUAL

INTRODUCTION AND OVERVIEW

PURPOSES

The OCC's Policies and Procedures Manual (PPM) describes the processes that the OCC uses for the internal review and approval of significant documents, including rulemaking documents.[1] This Rulemaking Manual (Manual) supplements the PPM by describing in detail the procedures that the OCC uses to develop and issue regulations.[2]

The purposes of the procedures set forth in this Manual are as follows:

- To facilitate the effective and efficient development and issuance of the OCC's regulations;
- To ensure that the OCC complies with the rulemaking requirements imposed by statutes such as the Administrative Procedure Act (APA) and the Regulatory Flexibility Act (Reg Flex Act) and by the executive orders that apply to various aspects of the rulemaking process, as well as with the applicable substantive requirements of the Federal banking laws;
- To promote coordination among the various OCC departments involved in the rulemaking process;
- To use an approach to rulemaking that:
    - ensures the opportunity for timely, substantive input into the rulemaking process by the Comptroller, the Executive Committee, and senior OCC officials, consistent with PPM 1000-10; and
    - makes full use of the range of cross-disciplinary expertise available from OCC staff resources; and
- To promote the integrity of the OCC's rulemaking processes by ensuring accountability in those processes and appropriate documentation of decision-making.

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[1] *See* "Internal OCC Review Processes for Policymaking, Rulemaking, and Other Significant Documents," PPM 1000-10 (REV) (April 26, 2005).

[2] This Manual is intended to serve as a guide for internal OCC processes and does not create any rights for third-parties.

OVERVIEW OF THE RULEMAKING PROCESS

An OCC rulemaking typically begins with the development and issuance of a notice of proposed rulemaking (NPRM). The NPRM contains the text of proposed additions or amendments to our rules and a preamble (referred to in the *Federal Register* as the Supplemental Information section) that explains the policy and legal bases for the proposed changes, their purpose, and the effect the changes would have on the institutions we supervise as well as any required regulatory analysis. The OCC publishes the NPRM in the *Federal Register* and invites public comment on it, usually for a period of no less than 60 days. After analysis and resolution of any issues raised by the commenters or by OCC staff, a final rule is prepared and published in the *Federal Register*. A rulemaking also may begin with an advance notice of proposed rulemaking (ANPR) that precedes the NPRM. An ANPR typically is used to solicit general comments and public input in an issue area that may be the subject of future agency rulemaking.

The process for developing and issuing final rules typically comprises four phases. The first phase, the project initiation phase, will vary depending upon the circumstances prompting the rulemaking. In many cases, the rulemaking is not discretionary. It may be required by statute or undertaken pursuant to interagency agreement, or specific initiative directed by the Comptroller. In those cases, the project initiation phase consists primarily of identifying the key OCC departments to be involved in developing the rule and the individuals on the rulemaking working group. When a rulemaking is undertaken on a discretionary basis to carry out the responsibilities of the agency or further the purposes and objectives of the National Bank Act, the Home Owners' Loan Act or other statutes administered by the OCC, a staff working group, under the sponsorship of one or more members of the Executive Committee develops an idea for a rulemaking by preparing materials describing proposed changes to the OCC's regulations, and the issues and consequences associated with adopting such changes. Executive Committee members and senior staff have the opportunity to review the materials and provide views about the desirability, scope, and content of the rulemaking project.

In the second phase of the project, a staff working group drafts an NPRM and supporting materials. The supporting materials typically include a Reviewers' Memorandum, circulated to the Comptroller, the Executive Committee, and other senior OCC officials with the Gold Border draft of the NPRM, which describes significant issues in the rulemaking, notes how the staff draft addresses them, and solicits input on the result. This Gold Border review may result in revisions to the draft NPRM, which are identified and explained in the Red Border memorandum that ultimately is provided to the Comptroller, together with a revised NPRM, for review and signature.[3]

In the third phase of the rulemaking, after the conclusion of the public comment period for the NPRM, the working group reviews comments and identifies and addresses significant issues raised by the commenters, consults with the Comptroller and senior OCC officials on how to proceed, and revises the proposed regulation accordingly. There is another Gold Border review process for the draft final rule, with a similar opportunity for review and comment by the Comptroller, the Executive Committee, and other senior OCC officials. Again, changes resulting from the Gold Border review are identified and explained in the Red Border package that is presented to the Comptroller for signature.

[3] The Gold and Red Border processes are described in detail in PPM 1000-10.

In the fourth and final phase of the project, documentation for the rulemaking is assembled, filed, and retained for the OCC's records.

Management of the Rulemaking Process

Rulemaking projects ordinarily are managed by the Legislative and Regulatory Activities Division (LRA) in the Law Department. LRA assigns an attorney – referred to in this Manual as the project manager – typically to lead the staff working group and manage the project. The project manager works closely with the LRA Assistant Director and Director to plan work, establish deadlines, and facilitate communication between the working group and senior OCC officials when, for example, issues require resolution before work on the project can proceed to the next step. The members of the working group may include supervisory, examination, licensing, or policy staff, as well as lawyers from other units in the Law Department, depending on the subject matter of the rulemaking project. Working groups are assembled with the goal of drawing on and using to maximum advantage the OCC staff resources having substantive expertise to contribute to the project. Executive Committee members have the opportunity to determine the units or staff members reporting to them that should participate in a rulemaking.

The project manager is responsible for leading and facilitating the identification and resolution of issues that arise in connection with the rulemaking, for preparing draft documents, and for ensuring that the OCC complies with the various rulemaking statutes and executive orders that apply to our rulemakings. The project manager relies on the expertise of working group members, but also is responsible for the substantive accuracy of the project documents. This means that the project manager should be, or become, as substantively knowledgeable about the area covered by the regulation as is feasible during the rulemaking process. The project manager also is responsible for coordinating any required economic analyses with the Policy Analysis Division (PAD).

The project manager is responsible for ensuring appropriate review of project documents within the Law Department – including review and clearance, as appropriate, by the Assistant Director and Director of LRA, the Deputy Chief Counsel, and the Chief Counsel, and by other senior officials of the OCC.

The project manager works closely with the LRA Regulatory Specialist, who is responsible for certain aspects of the OCC's compliance with the applicable statutes and executive orders, including the Paperwork Reduction Act (PRA), and for reviewing documents to ensure that they conform to *Federal Register* requirements. The Regulatory Specialist also serves as the OCC's liaison to the *Federal Register* and to the Office of Management and Budget (OMB) during the process of obtaining a major rule determination and PRA clearance, if necessary.

Finally, together with the Regulatory Specialist, the project manager ensures that all aspects of the rulemaking process are appropriately documented and that LRA records for the rulemaking are complete. All records relating to the rulemaking process are kept in accordance with Record Retention Act. *See* 44 U.S.C. § 3101.

Interagency Rulemakings

The OCC conducts rulemakings individually or together with other Federal agencies, often the other Federal banking agencies (the Federal Reserve Board and the FDIC). Interagency rulemakings are usually prepared by interagency working groups. The OCC is represented on these groups by such staff members as the Chief Counsel or other Executive Committee sponsor of the rulemaking may determine. The Chief Counsel or other Executive Committee sponsor typically will designate one staff member to serve as the lead OCC representative on the interagency group. In these cases, the project manager's responsibilities are adapted consistent with the purposes of the rulemaking and the roles assigned to other OCC staff members.

Contents of the Manual

This manual is organized into four chapters, one for each phase of the rulemaking process described in the Overview. Each chapter sets forth the procedures used in that phase of the rulemaking. Each chapter also contains a section entitled "Practice Tips," which provides guidance on common practical or technical questions that routinely arise in rulemakings. Finally, each chapter contains a "References" section that directs the project manager and other users to primary and authoritative secondary sources of standards or information pertaining to that phase of the rulemaking.

The "References" section may list both external and internal sources. External sources include, for example, the manuals, handbooks, or websites of Federal agencies such as the OMB or the Small Business Administration (SBA) that administer statutes or executive orders that apply to OCC rulemakings. Internal sources include OCC memoranda concerning those statutes and executive orders or other administrative law issues and sample work products of the type discussed in the Manual. These resources are available electronically in a shared electronic folder maintained by LRA. References are provided so that participants in each rulemaking need not repeat analysis that has been done before or search for sources of information that have previously been identified. Attorneys working on rulemaking projects are, however, responsible for ensuring that the research on a legal issue is current and that the analysis and forms provided are suitable for the particular project at hand. Prior memoranda and sample work product cannot substitute for consulting the primary sources – statutes and executive orders – and authoritative secondary sources directly.

Appended to the Manual is an "Attorney Checklist" that lists the procedures described here and details additional steps necessary to ensure that the procedures are successfully completed. The Checklist is intended to serve both as a reminder and guide to the project manager about what procedures are necessary and, when completed, as documentation that those procedures have been followed.

The procedures described in the Manual are those ordinarily used in rulemaking projects, subject to such exceptions as the Comptroller or the Executive Committee may direct. Adherence to these procedures should have the effect of improving the standardization, and therefore the transparency and predictability, of the OCC's rulemaking processes. They should facilitate, not replace, the exercise of judgment by the project manager and other staff working group members, however. It remains essential that staff members approach each rulemaking project individually and retain the flexibility to seek appropriate adjustment in procedures that do not suit the particular project.

CHAPTER I – INITIATING A RULEMAKING PROJECT

Each OCC rulemaking is sponsored, or co-sponsored, by the Chief Counsel, as the Law Department has responsibility for the legal sufficiency of the OCC's rulemakings. In rulemakings co-sponsored by the Chief Counsel together with another Executive Committee member, the Executive Committee-level review procedures and clearances described in this Manual either are conducted jointly by the co-sponsors or otherwise as the co-sponsors may direct.

This chapter describes the steps needed to begin a rulemaking project.

PROCEDURES

The OCC undertakes rulemaking in different types of circumstances: in many cases, we are required to do so by statutory directive or a rulemaking may be undertaken pursuant to an interagency agreement, typically among principals of the Federal banking agencies, or because a specific regulatory initiative is directed by the Comptroller. In other cases, we undertake a rulemaking on a discretionary basis to carry out the responsibilities of the Office or the purposes and objectives of the National Bank Act and/or the Home Owners' Loan Act. Most OCC rulemakings fall into the first category. Any additional steps needed in the case of discretionary rulemakings are specifically described in the procedures that follow.

1. Prepare a Project Initiation Memorandum for Discretionary Rulemakings

For discretionary rulemaking projects, the project manager prepares a project initiation memorandum for the signature of the Chief Counsel and Executive Committee co-sponsor, if applicable, and distributes the memorandum to the Executive Committee. The purpose of the memorandum is to solicit the views of the Comptroller, the Executive Committee, and other key OCC staff about undertaking the rulemaking project. The memorandum describes the purpose of the rulemaking and identifies the major substantive issues likely to be involved. It also identifies the units within the OCC that will likely have an interest in the rulemaking. The project initiation memorandum also may contain a preliminary timeline targeting completion dates for the principal parts of the process. A project initiation memorandum is not necessary if the rulemaking is mandated by statute or already agreed to or directed by the Comptroller.

2. Establish a Working Group

In consultation with senior Law Department managers as appropriate, the project manager must ensure the participation of units or staff members with expertise helpful to the project. In the case of discretionary rulemaking projects, the initiation, scope and direction of the rulemaking are subject to the views expressed by the Comptroller and other members of the Executive Committee in response to the project initiation memorandum.

The working group thus typically consists of the project manager, other attorneys within the Law Department, and staff from each OCC unit with expertise pertaining to the project. The working group members lend subject area expertise to the rulemaking project, including the identification and recommended resolution of substantive issues, make drafting recommendations, and review and comment on draft documents.

- **Note on Interagency Rulemakings.** Congress often requires banking agencies to write regulations necessary to implement new legislation jointly or in consultation with one another. Sometimes the banking agencies are required to consult or coordinate with other agencies, such as the Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC), or Federal Housing Finance Agency (FHFA). In such cases, interagency working groups are usually established. The OCC's representation on these interagency groups typically is determined in consultation with the Chief Counsel, who may designate a lead OCC representative who communicates the agency's position on issues that arise. If the LRA project manager is not the lead OCC representative, the project manager supports the lead and other participating OCC staff in preparing the draft rulemaking documents and internal OCC memoranda or, if the OCC does not have the primary drafting responsibility, in communicating OCC comments on drafts to the interagency working group and comments prepared by another agency internally to OCC staff.
    - Members of the interagency working group should set specific timetables and deadlines for the rulemaking process. Members should strive to resolve all issues or disagreements among the agencies through working group meetings, conference calls, or written communication. If disagreements cannot be resolved at the working group level, the project manager should present the issue(s) to the Chief Counsel or other appropriate Executive Committee member for the issue to be resolved by the agencies' senior management or principals.

3. Identify and Address the Issues

Convene Working Group Meetings. The project manager convenes an initial working group meeting to discuss the objectives of the rulemaking, discuss the contributions of the respective members of the group, and establish appropriate time frames. The project manager schedules subsequent meetings of the working group as needed to discuss and reach a recommended resolution of the substantive issues presented by the rulemaking.

Input From Senior OCC Management. OCC staff uses several methods to obtain input from senior OCC management in resolving significant issues that may arise in the rulemaking.

- *A group or subcommittee* of the OCC's Executive Committee may review and resolve issues pertaining to specific rulemakings. For example, to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203 (Dodd-Frank Act), the OCC formed the Financial Reform Oversight Group (FROG).

- The project manager, in consultation with the working group, may prepare *an issues memorandum* to seek senior management guidance on issues of significance in the rulemaking. The issues memorandum typically is more specific than the project initiation memorandum. It describes one or more proposed approaches to preparing the regulation, identifies and discusses major issues, and presents the working group's recommendations for resolving these issues. Upon completion, the Chief Counsel and Executive Committee co-sponsor, if applicable, sign the issues memorandum and it is distributed to the Comptroller and the Executive Committee. In appropriate circumstances, the matter may be scheduled for discussion by the Regulatory Policy, Legal, and External Affairs Subcommittee (RPLEA) of the Executive Committee.

- The project manager or Law Department management may conduct direct meetings with the Comptroller, Executive Committee members, or other senior OCC staff with expertise related to the rulemaking, *e.g.*, the project manager facilitates input from senior management, as needed, by ensuring that arrangements are made to obtain input in a timely fashion and by preparing any internal memoranda, coordinating briefings, or assembling any information necessary for senior managers to make informed judgments on the issues.

➢ **Note on Interagency Rulemakings.** Interagency rulemakings are often initiated without project initiation memoranda and the pacing of the interagency work may not allow time for the preparation of an issues memorandum. Nonetheless, these rulemakings frequently raise significant policy issues requiring guidance from senior OCC management, and it is essential that senior OCC management have the opportunity to provide that guidance before issues are resolved at the staff level by the interagency working group.

Address Comments Raised during the Issues Memorandum Review Process. The project manager collects reviewers' comments. Comments that raise significant substantive issues are discussed by the working group and brought to the attention of the Deputy Chief Counsel, the Chief Counsel, and senior OCC officials with expertise on the rulemaking, if applicable.

4. Contact the Policy Analysis Division

At this stage in the rulemaking, the project manager should contact the Director of the OCC's PAD to discuss the rule and request the assignment of an economist to the project. PAD will perform the economic analysis necessary to complete the regulatory analysis section of the preamble. This analysis is discussed in the next chapter.

PRACTICE TIPS

- All documents created for a rulemaking should be maintained in a separate directory in the project manager's g:\ drive. Documents should be clearly labeled and, if there are multiple versions of a document, the date should appear in the document name.

- The LRA Assistant Director and Director review the project initiation memorandum prior to distribution, and there may be other reviewers as well depending on the content of the rulemaking and the OCC units participating in it. Clearance by the Deputy Chief Counsel and the Chief Counsel is required for project initiation memoranda initiated by the Law Department.

- After the Chief Counsel and Executive Committee co-sponsor, if applicable, sign the project initiation memorandum or the issues memorandum, the project manager circulates the document for simultaneous review by the Comptroller and the Executive Committee. Copies of these and other rulemaking documents also are usually given to members of the working group, Law Department Division Directors, District Counsel, and any other reviewers who have a particular interest in the project.

- All rulemaking documents circulated to the Executive Committee for review must contain a tracking number for internal routing purposes. The number must be obtained before the document circulates. A staff member in the Comptroller's Office assigns the

tracking number. This tracking number is the same for all subsequent documents circulated for review that relate to the rulemaking project, except for the leading designation "IN" (for project initiation memo), "IS" (for issues memo), and "GB" (for Gold Border).

- Ordinarily, the project manager should request comments on the project initiation memorandum and the issues memorandum (and other rulemaking documents) within 2 weeks from the date of circulation. If review must be expedited, the attorney prepares a brief cover memorandum explaining the reason that expedited review is needed.

- The project manager retains copies of responses from Executive Committee members to all circulated documents for inclusion in the rulemaking file.

REFERENCES

- Sample project initiation and issues memoranda may be found on the LRA g:\ drive at g:\ADMIN LAW FILES BY TOPIC.

Chapter II – Preparing a Notice of Proposed Rulemaking

The rulemaking process usually begins with the issuance of a NPRM, which sets out and describes the proposed amendments to the OCC's regulations. In some instances, the OCC also may issue an ANPR before issuing the NPRM. An ANPR typically does not include regulatory text but usually contains a general discussion about the nature of the problem or issue to be addressed and solicits suggestions about how to approach it. For example, an ANPR may be used when the OCC wishes to solicit views about how to approach rulemaking in a new area not currently covered by our rules, or about which of two or more alternative approaches to regulating in a particular area would be more effective.

PROCEDURES

1. Develop and Draft the Proposal

The project manager schedules OCC staff working group meetings as necessary to discuss the content of the proposal. In consultation with the working group, the project manager prepares a draft NPRM. The NPRM consists of two parts: the proposed regulatory text and the preamble to these textual changes.

The project manager ensures that the NPRM conforms to applicable substantive legal requirements and the requirements of the APA. For example, in the early stages of a project, it may be necessary to consider whether the rulemaking falls within any exceptions to the APA's general requirement for notice and comment. At this stage of the project, consideration may also be given to whether the rulemaking warrants an enhanced opportunity for notice and comment, such as a public meeting or hearing. As a technical matter, the style of the NPRM also must be consistent with the drafting requirements contained in the *Federal Register* Document Drafting Handbook.

The regulatory text contains the proposed amendments to the OCC's regulations. The preamble explains the legal basis and supervisory reasons for the changes and describes their anticipated effect on national banks and/or savings associations. The preamble may contain questions or requests for comment on specific substantive issues. In addition, the preamble contains the required regulatory analysis of the proposal and requests comment on the proposal's effect on community banks and savings associations and the extent to which the proposal is consistent with plain language standards as required by section 722 of the Gramm-Leach-Bliley Act.

In general, the OCC requests comment on an NPRM for 60 days. The project manager discusses any shorter comment period with the Assistant Director and, as necessary, with senior Law Department management.

2. Ensure Compliance with Applicable Statutes and Executive Orders

The preamble to the proposal contains a section entitled "Regulatory Analysis" that describes how the OCC is complying or will comply with the requirements of the various statutes (in addition to the Federal banking laws) and executive orders that apply to our rulemakings.

The OCC conducts analyses in the following areas: the Paperwork Reduction Act (PRA), the Regulatory Flexibility Act (Reg Flex Act), the Unfunded Mandates Reform Act (UMRA), section 722 of the Gramm-Leach-Bliley Act, 12 U.S.C. § 4809 (plain language), and the Congressional Review Act (CRA) (enacted as part of the Small Business Regulatory Enforcement Fairness Act (SBREFA)).[4] These statutes require the OCC to determine the effect, or impact, a rulemaking will have according to the various standards they set forth. With the exception of the PRA and section 722 of the Gramm-Leach-Bliley Act, these determinations described in this paragraph are made by the Director of PAD in consultation with the Chief Counsel's Office, as appropriate. The project manager's requests for economic analyses, the analyses that PAD provides, and the determinations of the Director of PAD are documented in, and coordinated through, an exchange of memoranda that is described at Step 3, below. As described in the following discussion, the OCC's conclusions concerning the statutes also are documented through statements in the preamble to the NPRM, as well as in the rulemaking file. As the required regulatory analyses focus on the economic impact of the rule, they are an important component of the rulemaking process and should be carefully and comprehensively completed.

The Paperwork Reduction Act

The PRA generally provides that the OCC may not conduct a "collection of information" unless it receives approval from OMB, which indicates that the collection meets the policy criteria of the PRA and OMB's implementing regulations. A "collection of information" means obtaining, causing to be obtained, or soliciting information, or requiring that information to be obtained through identical questions or by identical reporting, recordkeeping, or disclosure requirements on at least 10 persons (including entities such as national banks and savings associations).[5] An information collection is subject to the requirements of the PRA without regard to whether it is mandatory, voluntary, or required to obtain or retain a benefit.[6]

To comply with the PRA, the OCC must demonstrate that the collection is the least burdensome necessary to obtain the information, does not duplicate available information, maximizes

[4] Pursuant to section 315 of the Dodd-Frank Act, which amended the definition of "independent agency" to include the OCC, the OCC is no longer subject to E.O. 12866. As a result, the OCC is not required to determine whether the rule is a "significant regulatory action" nor submit a Notice of Proposed Regulatory Action (NOPRA) for each rulemaking to the Office of Information and Regulatory Affairs (OIRA) of the OMB. In addition, pursuant to section 315, the OCC is no longer subject to E.O. 13132 and therefore is not required to follow that executive order's "Fundamental Federalism Principles" and "Federalism Policymaking Criteria" in developing any regulation that has Federalism implications..

[5] The Congressional Review Act is applicable only to final and interim final rules and is discussed in Chapter III.

[6] Although this Manual addresses the PRA only in the context of rulemaking, it is important to note that an information collection is subject to the requirements of the PRA whenever the OCC request information, regardless of whether it appears in a regulation, in guidance, or in any other type of OCC issuance, or any other form such as oral or electronic.

practical utility, and minimizes costs to the agency without shifting disproportionate costs or burdens to the public. In order to obtain OMB approval of an information collection contained in a rulemaking, the OCC must submit a clearance package to OMB that, in general, describes the information collection(s) in the proposal and estimates the amount of paperwork burden the collection imposes. The preamble also must contain this same information.

The project manager, together with the LRA Regulatory Specialist, identifies any provisions in the proposal that may impose paperwork burden. If the rule imposes paperwork burden, then the preamble must identify which sections impose the burden and estimate the average burden hours per respondent, the number of respondents, and the start-up cost (if any) of complying with the rule. The project manager and the LRA Regulatory Specialist, in consultation with client and other departments within OCC, develop this information. If the regulation imposes no paperwork burden, no PRA analysis needs to be included in the preamble.

If an ANPR contains regulatory text, the project manager reviews the ANPR under the PRA, but an OMB clearance package is not required. The preamble to the ANPR may request comments on paperwork burden issues.

- **Note on Interagency Rulemakings.** The OCC prepares its own PRA analysis for rulemakings conducted jointly or in coordination with other agencies. To ensure consistency to the greatest extent practicable, however, the Regulatory Specialist consults and coordinates with the other agencies in preparing the PRA material for inclusion in the preamble to the proposed rule.

To obtain OMB clearance under the PRA, the Regulatory Specialist submits a clearance package to OMB, in consultation with the project manager, the working group or client staff, and the LRA Assistant Director. This package is submitted via OMB's ROCIS System. It includes a supporting statement, citation to the NPRM, any applicable form or instrument, and citations to any relevant regulations and statutes. OMB has 60 days from the publication of the NPRM to either approve or file public comments on the paperwork collection contained in the NPRM. OMB also must provide at least 30 days for public comment during this 60-day period. The OCC must include any OMB comments in its rulemaking file.

The project manager should follow the procedures below to ensure compliance with the PRA and to complete the estimation of paperwork burden:

- Coordinate with the Regulatory Specialist to identify the paperwork imposed by the proposed rule;
- As necessary, meet with appropriate OCC staff to evaluate the costs of the paperwork burden imposed by the proposed rule;
- If an interagency rule, ensure that the OCC has consulted and coordinated with the other participating agencies in identifying and estimating paperwork burden;
- Ensure that the PRA paperwork burden determination and analysis comport with any economic analysis of the proposal conducted by PAD;

- If there are differences consult with PAD and the Regulatory Specialist to ensure proper coordination; and
- If differences remain, adequately explain such differences in the rulemaking file;

- Ensure that the Regulatory Specialist submits a PRA clearance package to OMB; and

- If necessary, ensure that the preamble to the proposed rule contains the necessary description of paperwork burden and request for comments regarding this burden.

The Regulatory Flexibility Act (Reg Flex Act)

With certain exceptions, the Reg Flex Act generally requires the OCC to review proposed regulations for their impact on small entities and, in certain cases, to consider less burdensome alternatives. After conducting this review, the OCC is required either to prepare and publish a Regulatory Flexibility Analysis or to certify that a Regulatory Flexibility Analysis is not required because the proposed rule will not have a "significant economic impact on a substantial number of small entities."[7] Executive Order 13272, Proper Consideration of Small Entities in Agency Rulemaking (Aug. 13, 2002), outlines the procedures each agency must establish to comply with the Reg Flex Act.[8]

SBA regulations currently define small entities to include banks and savings associations with total assets of $175 million or less.[9] The Reg Flex Act does not define the term "significant economic impact," nor does SBA guidance provide a bright-line definition. The SBA has said that "[s]ignificance should not be viewed in absolute terms, but should be seen as relative to the size of the business, the size of the competitor's business, and the impact the regulation has on larger competitors."[10] The SBA guidance, cited in the margin and in the References section of this chapter, provides examples of measures that may be useful for determining the significance of the economic impact of a rule. Similarly, neither the Reg Flex Act nor the SBA guidance defines what comprises a "substantial number" of small entities. The SBA guidance, however, discusses considerations that the SBA's Office of Advocacy views as appropriately influencing an agency's determination in that regard.

The Reg Flex Act does not apply to ANPRs (provided that they do not contain proposed regulatory text) and regulations not required to be issued pursuant to the APA's notice and

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[7] 5 U.S.C. § 605(b).

[8] E.O. 13272 states that each agency shall: establish procedures to promote compliance with the Reg Flex Act; review draft rules to assess the potential impact on small entities; issue procedures to ensure that this impact is properly considered; notify the SBA's Chief Counsel for Advocacy of draft rules that are covered by the Reg Flex Act. SBA notification shall be made when (a) an agency submits a draft rule to OMB/OIRA under E.O. 12866, or (b) if no OMB/OIRA submission is required, at a reasonable time prior to rule publication. The agency must give consideration to any SBA comments and respond to these comments in the explanation of the final rule.

[9] *See* 13 C.F.R. 121.201 (Sector 52, Subsector 552). This dollar figure is adjusted periodically for inflation.

[10] SBA Office of Advocacy, A Guide for Government Agencies, How to Comply with the Regulatory Flexibility Act (Implementing the President's Small Business Agenda and Executive Order 13272) at 17 (May 2003).

comment procedures. Thus, the Reg Flex Act does not apply if the agency finds, for good cause, that notice and comment are not required.

The Reg Flex Act permits the OCC to decide not to prepare a Regulatory Flexibility Analysis if the Comptroller certifies that the regulation "will not, if promulgated, have a significant economic impact on a substantial number of small entities."[11] In analyzing whether the rule is eligible for this certification, the PAD, identifies the number of small banks and savings associations that would be subject to the proposed requirements and the actions that small banks and savings associations would have to take in order to comply with them.

The Director of PAD, in consultation with the Chief Counsel's Office, determines whether the regulation is eligible for certification. If the regulation is eligible for certification, the project manager prepares and includes in the preamble to the proposal a certification substantially similar to the following:

> *The OCC certifies that this regulation, if adopted, will not have a significant economic impact on a substantial number of small entities. Accordingly, a Regulatory Flexibility Analysis is not required.*

This statement is followed by a brief explanation of the factual basis for the certification. The SBA's Office of Advocacy interprets this "factual basis" requirement to mean that, at a minimum, a certification should contain a description of the number of affected entities and the size of the economic impacts and why either the number of entities or the size of the impacts justifies the certification. Therefore, a certification should state more than simply that the agency has found that the proposed or final rule will not have a significant economic impact on a substantial number of small entities.

Pursuant to E.O. 13272, if the rule is not eligible for certification, the Regulatory Specialist, in consultation with the project manager and the Assistant Director, notifies the SBA's Chief Counsel for Advocacy of the draft proposed rule "at a reasonable time" prior to its publication. The OCC also must give "appropriate consideration" to any comments provided by SBA regarding such a proposed rule and include in the preamble to the final rule the OCC's response to the SBA's written comments. However, such a response is not required if the Comptroller certifies that the public interest would not be served by doing so.

The project manager then completes the following steps:

Prepare an Initial Regulatory Flexibility Analysis (IRFA). If the proposal is not eligible for certification, that is, if it is likely to have a significant economic impact on a substantial number of small entities, the project manager prepares an IRFA in consultation with PAD. The Reg Flex Act requires that the IRFA include:

- A description of the reasons why the proposal is under consideration;
- A succinct statement of the objectives of, and the legal basis for, the proposed rule;

[11] 5 U.S.C. § 605(b) (Reg Flex Act certification provision).

- A description of, and where feasible, an estimate of the number of small entities to which the proposed rule will apply;

- A description of the projected reporting, recordkeeping and other compliance requirements of the proposed rule, including an estimate of the classes of small entities that will be subject to such requirements and the type of professional skills necessary for preparation of the report or record;

- An identification, to the extent practicable, of all relevant Federal rules that may duplicate, overlap or conflict with the proposed rule; and

- A description of any significant alternatives to the proposed rule that accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities, including a discussion of significant alternatives such as:

    - The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities;
    - The clarification, consolidation or simplification of compliance and reporting requirements for small entities;
    - The use of performance standards rather than design standards; and
    - The exemption from the rule, or any part of the rule, for small entities.

Transmit a complete copy of the IRFA to Advocacy for review. The OCC should not publish the NPRM in the *Federal Register* until we receive the results from Advocacy of their review. We should indicate to Advocacy in our submission any deadlines we have for the publication of the NPRM.[12]

Make the IRFA available to the public. The IRFA must be made available to the public. This can be done by publishing the complete IRFA in the preamble to the NPRM or by including in the preamble a summary of the IRFA and a statement describing how copies of the complete analysis may be obtained from the OCC.

➢ **Note on Interagency Rulemakings.** The OCC independently determines the applicability of the Reg Flex Act and the eligibility of a rulemaking for certification under the Act for rulemakings conducted jointly or in coordination with other agencies. To ensure consistency to the greatest extent practicable, however, the project manager and the Regulatory Specialist consult and coordinate with the other agencies in preparing material pertaining to the Reg Flex Act for inclusion in the preamble to the proposed rule.

[12] Pursuant to 5 U.S.C. 609(b) of the RFA, this requirement only applies to "covered agencies," defined in 609(d) as the EPA and OSHA. However, the OCC complies with this requirement and SBA encourages agencies to do so.

Unfunded Mandates Reform Act (UMRA)

Consistent with the UMRA,[13] the OCC assesses the effects of Federal regulatory actions on State, local, and tribal governments, and the private sector other than to the extent a proposed regulation incorporates requirements specifically set forth in law. The UMRA does not apply to ANPRs.

UMRA provides that agencies must prepare a written statement containing certain information and analysis specified in the statute if a proposed rule contains a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year. As a general matter, a Federal mandate is any provision in legislation, statute, or rule that would impose an enforceable duty on the private sector. However, pursuant to section 201 of the UMRA[14], a regulation does not impose a mandate to the extent it incorporates requirements "specifically set forth in the law." A summary of the written statement must be contained in any NPRM or Final Rule.

The Director of PAD, in consultation with the Chief Counsel's Office, as appropriate, determines whether the requirements of the UMRA are triggered. If so, then the UMRA requires that the preamble contain a budgetary impact statement.[15] The OCC then also must identify and consider a reasonable number of regulatory alternatives before promulgating the rule. In such a case, PAD prepares the economic analysis required for the budgetary impact statement, and the project manager and PAD (together with the working group, as appropriate) work in coordination to develop regulatory alternatives.

If the $100 million threshold is not exceeded, the project manager prepares and includes in the preamble to the proposal a statement to that effect together with a brief reason supporting that conclusion.

- **Note on Interagency Rulemakings.** The OCC independently determines whether the UMRA requires the preparation of a budgetary impact statement. The UMRA does not apply to the Federal Reserve Board and the FDIC.

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[13] 2 U.S.C. 1501 *et seq.*

[14] 2 U.S.C. 1531.

[15] Section 202(a), 2 U.S.C. § 1532, requires this written statement to include: (1) the legal authority for the rule; (2) a qualitative and quantitative cost-benefit assessment of the Federal mandate (including the costs and benefits to State, local, and tribal governments or the private sector and the available Federal resources to fund this mandate, as well as the effect of the Federal mandate on health, safety, and the natural environment); (3) feasible estimates of future compliance costs and any disproportionate budgetary effects on various governmental or private sectors; (4) a description of the macro-economic effects of the mandate, if feasible; and (5) a description of any required agency consultation with elected representatives of the affected State, local, and tribal governments. In addition, section 205 of the UMRA, 2 U.S.C. § 1535, requires an agency to identify and consider a reasonable number of regulatory alternatives and select the least costly, most cost-effective or least burdensome alternative for, as applicable, State, local, tribal governments, and the private sector that achieves the objectives of the rule.

3. Coordinate Economic Analysis with PAD

The Director of PAD, in consultation with the Chief Counsel's Office, as appropriate, makes the determinations required pursuant to the Reg Flex Act and the UMRA. PAD prepares the economic analyses necessary to support those determinations. The project manager works with PAD to provide legal support for this analysis. To facilitate PAD's work in this regard, during the development of the NPRM, the project manager sends a memorandum to the Director of PAD requesting PAD's economic analysis of the proposed rule and the determinations of the Director of PAD pursuant to the Reg Flex Act and the UMRA. PAD's analysis will be used to complete the regulatory analysis section of the preamble. This memorandum should include a description of these laws, a summary of the draft proposal, and a description of those sections of the proposal that will impact national banks and savings associations, identifying any mandates in the proposed rule. The attorney also should attach a draft of the NPRM. This memorandum should be sent to PAD no later than the distribution of the Gold Border package. It should request that PAD provide the project manager with their written response no later than the Gold Border comment due date. For more complex rulemakings, the memorandum to PAD should be sent at an earlier date. These determinations and analysis typically are set forth in a memorandum that PAD provides to the project manager.

- If the substance of a rule changes following receipt of PAD's analysis, the project attorney must request PAD to revise the analysis based on the changes and provide an updated analysis memorandum, approved by the Director of PAD, as soon as possible.

- The project manager must ensure that this updated analysis memorandum, in a suitable form, adequately reviews the costs associated with the revisions to the proposed rule, and contains the economic analyses necessary to support determinations required pursuant to the Reg Flex Act, and UMRA.

The project manager must review the UMRA and PRA analyses, bring any discrepancies between the two to the attention of PAD and the Regulatory Specialist, and ensure that the rulemaking file contains an adequate explanation of any differences.

The project manager retains copies of memoranda sent to and received from PAD for the rulemaking file.

PAD has developed additional procedures to facilitate the development and coordination of economic analyses. Among other things, these procedures note that PAD may refer to OMB Circular A-4 in preparing certain economic analyses. Project managers should familiarize themselves with these procedures, a copy of which is attached as Appendix I.

4. Prepare and Distribute a Gold Border Package

The OCC uses the Gold Border process to ensure that the Comptroller and other senior OCC officials have an opportunity to review and comment on significant agency documents, including rulemaking documents, and to facilitate that process on an efficient basis. When the draft *Federal Register* document for the proposed rule is finished, the project manager prepares a Gold Border package for clearance and circulation.

The Gold Border package consists of the draft *Federal Register* document containing the NPRM, the Gold Border Reviewers' Memorandum (Gold Border Memo), and the Gold Border cover sheet.

Gold Border Memo. The Gold Border memorandum is a memorandum, usually prepared for the signature of the Chief Counsel and Executive Committee co-sponsor, if applicable, to those individuals who will be reviewing the Gold Border package (Gold Border Reviewers). It typically contains a summary of the most significant provisions of the proposal, a description of any major issues presented by the NPRM, and recommendations for resolving those issues. If staff views differ with respect to resolution of significant issues, the differences and the reasons for them are explained. The Gold Border memorandum also may seek input on any other issues that have arisen during the drafting process.

Gold Border Cover Sheet. The Gold Border cover sheet provides a vehicle for distributing the Gold Border package. The cover sheet, which for hard copy distribution is printed on gold paper, contains a very brief summary of the proposed rule.

The cover sheet indicates a due date for comments, usually two weeks after the distribution date. If a shorter review period is necessary, the cover sheet should highlight the shorter deadline and explain the circumstances warranting the need for expedited review unless otherwise directed by the Chief Counsel. Gold Border reviewers for rulemakings always include the Comptroller, the members of the Executive Committee, the Director of PAD, the Deputy Comptroller for Public Affairs, the Director for Congressional Liaison, the Director for Press Relations, the Director of Public Affairs (Operations), the District Deputy Comptrollers, Deputy Chief Counsels, Law Department Division Directors, and District Counsels. Particular Deputy Comptrollers and other reviewers may be added depending on the content of the proposal. Courtesy copies of the package may be provided to OCC staff working group members or other interested staff.

The Gold Border reviewers are asked to return the cover sheet, with any comments on the draft, to the project manager.

- **Note on Interagency Rulemakings.** The timing of the distribution of the Gold Border package is especially important in interagency rulemakings. Each of the Federal banking agencies (and other agencies with which the OCC may be required to consult on rulemakings) has a different process for review and clearance of rulemaking documents. It is essential that OCC senior management have an opportunity to review and comment on a rulemaking document in a time frame that permits the project manager and other OCC staff to communicate their views to the interagency staff working on the projects. Timing of the Gold Border package should be discussed with the Assistant Director, the Director, and senior OCC management as needed.

    - If agency staff on the interagency working group cannot reach agreement on a substantive or procedural aspect of the rulemaking, the gold border package should explain this disagreement and summarize the OCC position. If interagency staff is unable to resolve the disagreement, the project manager should raise the issue(s) with the Chief Counsel or other appropriate Executive Committee member for the issue to be resolved by the agencies' senior management or principals.

5. Review and Address Gold Border Comments

The project manager prepares a brief summary of significant Gold Border comments. The summary is circulated to the OCC working group, LRA managers, the Deputy Chief Counsel, and the Chief Counsel and Executive Committee co-sponsor, if applicable, for simultaneous review. If necessary, the project manager initiates an OCC and/or interagency working group meeting to discuss significant, substantive Gold Border comments. As appropriate, the project manager discusses comments with the Chief Counsel and makes recommendations about how to address the comments. The project manager ensures that Gold Border reviewers are made aware of how their comments have been addressed. This may occur informally through discussion between the Chief Counsel and Executive Committee co-sponsor, if applicable, and the members of the Executive Committee or through staff-to-staff communications, depending on the nature of the issue. The project manager retains copies of the Gold Border comments for the rulemaking file. If there are significant changes to the NPRM based on the Gold Border package, the project manager should request PAD, by memorandum, to review their regulatory analysis in light of these changes.

6. Prepare and Distribute Red Border Package

Once any issues raised by Gold Border commenters (or, in the case of an interagency rulemaking, by other agencies) have been resolved, the project manager revises the NPRM and prepares the Red Border package. This package consists of the revised draft NPRM, the Red Border Decision Memorandum, and the Red Border cover sheet.

- **Note on Interagency Rulemakings.** The project manager also incorporates comments received from the other agencies where the OCC is the lead drafting agency. If another agency is drafting the rule, the project manager should review this draft to make sure that OCC Gold Border reviewers' comments have been incorporated.

Red Border Decision Memorandum. The Red Border Decision Memorandum is prepared for the signature of the Chief Counsel and Executive Committee co-sponsor, if applicable, for transmittal to the Comptroller. The memorandum briefly summarizes the major provisions of the rule and highlights any significant changes from the Gold Border version of the draft NPRM. The memorandum also may indicate how comments sent by Executive Committee members during the Gold Border process have been addressed.

Red Border Cover Sheet. The Red Border cover sheet transmits, and contains a brief description of, the proposed rule. Use the OCC template for this form.

When the Red Border materials are complete and the Chief Counsel and Executive Committee co-sponsor, if applicable, have signed the Red Border memorandum and cover sheet, the package is sent to the Comptroller for signature. The project manager alerts reviewers and staff participants in the rulemaking that the package has been sent to the Comptroller to sign. Because the time between transmittal to the Comptroller and signature is usually fairly short, the project manager need not distribute copies of the Red Border package to reviewers and staff participants except upon request. The project manager provides copies of the signed NPRM Red Border package to reviewers and staff participants.

- **Note on Interagency Rulemakings.** Sometimes, there is interagency negotiation on the language of a rulemaking document late in the process of its review and approval. The project manager facilitates communication among the agencies and ensures that the OCC's position on issues on which there is disagreement is reflected in the documents or that the issue is brought to the attention of the Chief Counsel, and Executive Committee co-sponsor, if applicable, other senior OCC managers, or the Comptroller for resolution.

Coordinate with Public Affairs. The Director of Public Affairs (Operations) will have been alerted to the progress of the rulemaking project through receipt of the Gold Border package. Well ahead of the date on which the NPRM will be released, the project manager consults with Public Affairs (Operations) about whether that office will need materials describing or explaining the NPRM. As needed, the project manager assists in the drafting of a press release and prepares a Q & A document or talking points for use by Public Affairs. If the rulemaking is expected to generate significant interest, the project manager consults with the Chief Counsel, Executive Committee co-sponsor, if applicable, and other senior OCC managers about the need for similar materials for distribution to other OCC staff members, including Congressional Liaison, EICs, or District Deputy Comptrollers and their staffs.

- **Note on Interagency Rulemakings.** The participating agencies ordinarily issue a joint press release (if any release is issued) for interagency rulemakings. Public Affairs coordinates the drafting and release of the press statement with the other agencies. However, the draft interagency press release should be reviewed by the project manager and LRA management, as appropriate, prior to release.

7. Coordinate Publication and Distribution of the NPRM

After the Red Border package has been signed by the Comptroller, the project manager coordinates the publication and distribution of the NPRM by taking the following steps.

Submission to and Publication in the Federal Register. The Comptroller's Office returns the Red Border package to the project manager after the Comptroller has signed and dated the Red Border cover sheet (indicating the Comptroller's decision) and signature page. LRA's Regulatory Specialist then coordinates submission of the document to the *Federal Register*, which is done both electronically and by paper copy. The project manager provides the Regulatory Specialist with an electronic copy of the signed version of the NPRM. The Regulatory Specialist notifies, and provides an electronic copy to, reviewers and staff who have participated in the rulemaking. The Regulatory Specialist includes a copy of the submission for inclusion in the rulemaking file.

- Before the document is sent to the *Federal Register*, the project manager obtains the Chief Counsel's prior approval to publish in the *Federal Register*. This can be done via email.

- The paper submission to the *Federal Register* consists of the original NPRM, with the original signature of the Comptroller and two certified copies of the NPRM.

The Regulatory Specialist coordinates any revisions requested by the *Federal Register* and clears all substantive revisions with the project attorney.

Upon publication in the *Federal Register*, the Regulatory Specialist notifies interested parties and distributes the *Federal Register* version of the NPRM via email.

The project manager proofreads the *Federal Register* version to locate any printing errors. If any *Federal Register* errors are noted, the Regulatory Specialist, in consultation with the project manager and LRA management, notifies the *Federal Register* and arranges for a correction to be printed. If the OCC is responsible for the error, the project manager prepares a correction document revising the NPRM and circulates it on Red Border for the signature of the Comptroller and subsequent publication in the *Federal Register*. The Chief Counsel may act under delegated authority to approve technical revisions to a *Federal Register* document.[16]

Preparation and Distribution of the OCC Bulletin. At the conclusion of the Red Border process, the project manager prepares an OCC Bulletin, which is the document the OCC uses to transmit a rulemaking document to national banks, Federal savings associations, and OCC staff. This document informs the reader that the document was published in the *Federal Register*, summarizes the major points of the NPRM, and includes an attached copy of the *Federal Register* document. The project manager should prepare a draft of the bulletin in accordance with the OCC's Style Manual and send a draft of this bulletin to Communications for review. After Communications has reviewed the bulletin, the project manager circulates the document on a Green Border.

After the NPRM is published in the *Federal Register*, the project manager provides Communications with an electronic copy of the final *Federal Register* document and the final Bulletin, along with the hard copy of the Bulletin signed by the Chief Counsel and Executive Committee co-sponsor, if applicable. Communications handles the distribution of the Bulletin and attached *Federal Register* document.

[16] *See* "Delegation of Authority – Federal Register Materials" from the Comptroller of the Currency to the First Senior Deputy Comptroller and Chief Counsel, dated January 5, 2009.

Practice Tips

Drafting the NPRM

- It is usually best to draft the regulatory text first – before the preamble – since the preamble should describe and explain the text. A section-by-section format for the preamble is helpful to provide a clear explanation of the regulatory text.

- The project manager should verify the statutory authority citation for the OCC rule and use as the base for all amendments the latest version of the rule. The most current information can be found using the e-CFR.

- Specific questions for commenters about the rulemaking set forth in the preamble should be numbered, and the preamble should request commenters to respond to these questions by number. This will allow the OCC to more easily review, summarize and organize public comments, especially in rulemakings for which we expect a large number of comment letters.

- Consult with the Regulatory Specialist to ensure compliance with *Federal Register* drafting requirements, which are set forth in the *Federal Register* Document Drafting Handbook, which may be found at http://www.archives.gov/federal-register/write/handbook/ddh.pdf. The *Federal Register* handbook also refers to the GPO's Style manual, which may be found at http://www.gpoaccess.gov/stylemanual/browse.html.

- Use plain language drafting techniques, as appropriate. Consult the REFERENCES section of this chapter for plain language resources.

- The project manager should consult with LRA staff for examples of recent proposed rules that could serve as a template.

Ex Parte Communications[17]

- OCC staff are not prohibited from meeting with outside parties, engaging in discussions with those parties, or accepting documents from those parties before the NPRM is issued, but those actions raise issues of transparency and fairness of the rulemaking process. OCC policy is that such discussions, and any documents received, that involve substantive issues of the merits of the possible rulemaking must be documented for inclusion in the rulemaking file. This rule also applies after an ANPR is issued. *See* "Procedures, 1. Review and Summarize Public Comments, Note on Meetings with Outside Parties" in Chapter III for more information on OCC policy regarding such communications.

[17] The APA defines an *ex parte* contact as an "oral or written communication not on the public record with respect to which reasonable prior notice to all parties is not given." 5 U.S.C. § 551(14). Requests for status reports on a rulemaking (and responses by agency staff to such requests) are not *ex parte* communications under this definition. *Id.*

Ensuring compliance with applicable statutes

- The list of statutes and executive orders described in the PROCEDURES section is not necessarily exclusive. Consult with the Assistant Director early in the drafting process to be sure other laws, *e.g.*, the Federal Advisory Committee Act, do not apply or require special procedures. Check references and Web sites to ensure that the information you have is the most current available.

- Agency certifications and Final Regulatory Flexibility Analyses (FRFAs) under the Reg Flex Act for final rules are subject to judicial review. Deficient certifications and FRFAs invite unnecessary litigation risk and could result in a final rule being remanded back to the OCC for additional Reg Flex analysis.

- Perform, or coordinate, the analyses required under the statutes concurrently with the drafting of the *Federal Register* document so that they can be included in the Gold Border package for review, if possible.

The OMB clearance process under the PRA

- The OMB clearance process for PRA can affect the timing of publication of the NPRM and present unexpected delays. Coordinate with the LRA Regulatory Specialist on this as early as feasible in the drafting process.

Preparation and distribution of the Gold Border package

- Insert the tracking number on the Gold Border cover sheet, with the initial designation "GB." Contact the Comptroller's Office, ext. 4880, for the number, if a number has not previously been assigned to the project.

- Confirm that comments have been received from all Gold Border Reviewers at the end of the Gold Border comment period. If an Executive Committee member has not commented, contact his or her executive assistant to ascertain whether the EC member plans to comment and the likely timing of the comment.

Preparation and distribution of the Red Border package

- When the Red Border rulemaking document contains important changes to the version that circulated on Gold Border, it is often helpful to prepare a redlined version of the NPRM, marked to show changes to the Gold Border version, to facilitate review of the Red Border package by the Comptroller.

- The Comptroller's Office assigns the Red Border a log number, which they should insert on the cover sheet. The package must have a log number before it is given to the Comptroller. The log number is different from the tracking number referred to above.

- The Comptroller needs to sign only one copy of the *Federal Register* document. If the signature page is returned with the date line blank, check with the Comptroller's office as to the date it was signed and insert that date. The *Federal Register* does not accept an auto-penned document.

- Two copies are certified by stamping them with the certification stamp. The stamped copies are signed by the Regulatory Specialist, or an OCC manager who supervises this staff member (*e.g.*, the Assistant Director, the Director, etc.).

REFERENCES

- National Archives and Records Administration, Office of the *Federal Register*, *Federal Register* Document Drafting Handbook, *available at* http://www.archives.gov/federal-register/write/handbook/ddh.pdf.
- The GPO's Style Manual, available at http://www.gpoaccess.gov/stylemanual/browse.html.
- The OCC's Style Manual (revised 2011) is available on the OCC's intranet site at http://occnet.occ/OCCnet/publicaffairs/style.pdf.
- Plain language resource materials are available at http://www.plainlanguage.gov/resources/index.cfm.
- Paperwork Reduction Act of 1995, 44 U.S.C. § 3501 *et. seq.* *See also* 5 C.F.R. Part 1320 (OMB implementing regulations for PRA); Office of Information and Regulatory Affairs, Office of Management and Budget, The Paperwork Reduction Act of 1995: Implementing Guidance for OMB Review of Agency Information Collection (draft, August 16, 1999) (unpublished, available from LRA Regulatory Specialist).
- Regulatory Flexibility Act, 5 U.S.C. § 600 *et. seq.* Executive Order 13272, "Proper Consideration of Small Entities in Agency Rulemaking" (August 13, 2002). *See also* SBA Office of Advocacy, A Guide for Government Agencies: How to Comply with the Regulatory Flexibility Act (2003), *available at* www.sba.gov/advo/laws/rfaguide.pdf.
- Administrative Procedure Act, 5 U.S.C. §§ 553-559.
- Unfunded Mandates Act of 1995, Pub. Law 104-4, 2 U.S.C. § 1501.
- Gramm-Leach-Bliley Act, Pub. Law 106-102, 12 U.S.C. § 4809.
- Executive Orders are available at: http://www.archives.gov/federal-register/executive-orders/disposition.html.
- United States Attorney General's Manual on the Administrative Procedure Act (1947), available at http://www.oalj.dol.gov/public/apa/refrnc/agtc.htm. Other administrative law resource materials available at http://www.oalj.dol.gov/libapa.htm.
- OCC's independent regulatory authority: 12 U.S.C. § 1 (cross-referencing 12 U.S.C. § 1462a(b)(3)).
- Sample documents, including sample gold border comment summary, sample economic analyses, sample IRFA, may be found on the LRA g:\ drive at g:\ADMIN LAW FILES BY TOPIC.
- Templates for gold border and red border cover sheets are available in the "OCC Forms" section of Word.
- CFR List of Subjects, available on the LRA g:\ drive at g:\OCC Rulemaking Procedures\CFR LIST OF SUBJECTS.doc.
- "Internal OCC Review Processes for Policymaking, Rulemaking, and Other Significant Documents," PPM 1000-10 (REV) (April 26, 2005).
- OCC memoranda on various topics of administrative law may be found on the LRA g:\ drive at g:\ADMIN LAW FILES BY TOPIC.

CHAPTER III – PREPARING A FINAL RULE

PROCEDURES

The procedures for preparing a final rule are similar to those that the OCC uses for preparing a proposal. Accordingly, this chapter highlights the aspects of the final rule process that are different from the NPRM process and cross-references the NPRM procedures in Chapter II where appropriate.

1. Review and Summarize Public Comments

Periodically while the comment period is open, and at the end of the comment period, the project manager obtains copies of public comment letters sent to the OCC in response to our request for comments in the NPRM. Shortly after the comment period has closed, the project manager prepares a summary of the public comments on the NPRM. The format for the summary is determined by the subject matter and complexity of the proposal; however, it is often helpful to categorize the comments by subject matter or CFR cite. The comment summary also indicates the type or identity of commenters raising significant issues.

- In some rulemakings, other agencies may submit comment letters to the OCC. The OCC typically addresses these comment letters in the preamble. In cases where agencies disagree with the OCC's approach in the proposal, the OCC typically seeks to contact the agency to obtain further information about their comment. Any such communication should be documented in the rulemaking file. (*See* "Note on Meetings with Outside Parties," below.)

The project manager circulates the comment summary simultaneously to OCC staff, interagency staff if applicable, and OCC managers. Copies of the letters typically are not provided for review, unless a reviewer asks for them.

The project manager is responsible for reviewing the docket and ensuring that comment letters are accurately posted to O:\FR COMMENTS by Communications staff and to www.regulations.gov by LRA staff. *See* **"Practice Tips - Docket Management: Public Comments"** for specific instructions.

- **Note on Interagency Rulemakings.** In an interagency rulemaking, each agency prepares its own summary of the comments it received. These comment summaries are shared with the other agencies.

- **Note on Meetings with Outside Parties.** Meetings or other discussions between OCC officials and national banks or other interested parties during the pendency of a rulemaking are not prohibited under the APA. However, such communications could cause questions to be raised about the transparency and fairness of the OCC's rulemaking processes. To avoid even the appearance of unfairness in this regard, the OCC applies the following policies:

    - Due to the time demands placed on OCC resources by such meetings, OCC staff generally try to limit meetings to those involving national banks or Federal savings associations. National banks, Federal savings associations or their

representatives, or other parties, wishing to arrange an in-person meeting will be asked to submit an outline of the points they wish to present at the meeting. This outline is not an agenda of topics but rather should summarize the points the parties intend to make at the meeting. The outline, together with documentation of the meeting prepared by an OCC staff member, will be made a part of the public record, for example, through posting together with other comments on regulations.gov. A summary of the discussion need not be prepared by OCC staff if materials submitted by the party and included in the rulemaking file are sufficiently comprehensive.

- OCC staff will inform the external party that such a summary and/or materials will be made a part of the public comment file and that they should identify any confidential business or proprietary information in the material.
- Informational discussions, including explanations of the published proposal, information about status or timing of the rulemaking, or a private party's cursory expressions of opinion unaccompanied by reasoned support, need not be documented.[18]

2. Develop and Draft the Final Rule

The project manager convenes or requests meetings as necessary to discuss and develop recommended responses to issues raised by the commenters, including meetings with the OCC or interagency working group and with the Chief Counsel, Executive Committee co-sponsor, if applicable, and other OCC senior managers. Based on the input received, the project manager drafts the regulatory text and preamble for the final rule. In some cases – particularly where the resolution of a legal issue is crucial to the content of the final rule – consideration should be given to developing a memorandum that clearly sets forth and explains the legal basis for the final rule. The project manager should consult with senior Law Department managers, including the Chief Counsel, before undertaking to prepare such a memorandum.

The project manager also ensures that any outstanding legal issues, or issues arising as a result of OCC (or interagency) staff review and discussion, are resolved. This includes any administrative law issues, such as whether a provision to be included in the final rule is a "logical outgrowth" of the proposal under the applicable APA case law. The APA also contains a few express requirements that apply to final rules, including that the final rule document contain a statement of the basis and purpose of the rule and that its effective date be delayed, subject to certain exceptions.

The project manager ensures that the final rule complies with any applicable delayed effective date requirements. With certain exceptions, the APA requires that final rules take effect no earlier than 30 days after the date of publication in the *Federal Register*. In addition, with exceptions that parallel those in the APA, the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRI Act) requires rules that impose additional reporting, disclosure, or other new requirements to take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form. The APA delayed effective date operates as a "floor," *i.e.*, the effective date of a final rule usually can be no earlier than 30

[18] OCC policy is that *ex parte* discussions that occur before an NPRM is issued require similar documentation that eventually will be included in the rulemaking file. *See* "Practice Tips, Drafting the NPRM," Chapter II.

days after publication and, if the rule is covered by the CDRI Act, the effective date will be 30 days plus the number of days until the first day of the calendar quarter following publication.

The OCC may cause a final rule to take effect sooner than the effective dates prescribed by the APA and CDRI Act upon a finding of "good cause" to do so, provided the basis for the finding is published in the preamble to the final rule.

The regulatory text consists of the amendatory text contained in the proposal with edits based on the public comments received. The preamble usually includes a summary of the proposed rule; the number of comments received, usually grouped by type of interested party; a summary of the comments received and the OCC's (or interagency) response to the comments; and a description of the final rule, usually in section-by-section format, that highlights any changes from the proposal. The preamble also includes the required regulatory analyses.

- Each public comment letter received need not be separately addressed in the preamble. The APA requires that the preamble to the final rule address significant issues concerning the proposal raised by the comment letters. Comment letters that address the same point(s) may be summarized as a group.

3. Ensure Compliance with Applicable Statutes and Executive Orders

The project manager works with the PAD, the Regulatory Specialist, and the working group to finalize the regulatory analyses for the final rule. The project manager should do these analyses concurrently with the drafting of the Gold Border package, if possible.

The PRA

Refer to Chapter II for a discussion of the requirements of the PRA. The PRA and OMB's implementing regulations prescribe particular requirements for information collections contained in final rules.

If the information collection contained in the NPRM remains unchanged in the final rule, the project manager includes in the preamble a statement that the final rule contains a collection of information; that the information collection was submitted to and approved by OMB; whether public comments were received on the information collection and, if so, how they were addressed. The preamble to the final rule includes the OMB control number assigned to the collection and indicates that failure to display the OMB control number has legal significance.

If the information collection contained in the NPRM has changed in the final rule, the Regulatory Specialist makes a revised submission to OMB on or before the date the final rule is published. The preamble to the final rule states that the final rule contains a collection of information; that the information collection was submitted to and approved by OMB at the proposed rule stage and was assigned a particular OMB control number; and that failure to display the OMB control number has legal significance. The preamble also states how the collection has changed; whether public comments were received on the information collection and, if so, how they were addressed; and what the new burden estimates are.

In addition, the preamble indicates that the rule has been resubmitted to OMB for review. It notes that the provisions that do not contain PRA requirements can go into effect but that the effective date of the final rule's information collection requirements are stayed until the OCC receives OMB approval. OMB has up to 60 days to complete its review and provide approval. When approval is received, the OCC must publish a notice in the *Federal Register* and include the OMB control number and statement of legal consequences.

If OMB has filed comments on the collection of information aspects of the NPRM, the OCC must resubmit the revised collection for review at the final stage of rulemaking. The preamble to the final rule must explain how any collection of information contained in the final rule responds to comments received from OMB, as well as any comments from the public. The OCC must explain any substantive or material change to the rule.

The Reg Flex Act

Even if the OCC has certified that an NPRM would not result in a final rule having a significant economic impact on a substantial number of small entities, the OCC may conclude that changes made in the final rule cause it to be likely to have such an impact.[19] In such a case, the OCC must determine whether preparation of a Reg Flex Act analysis for the final rule is required. Chapter II, *supra*, discusses how this determination is made.

If the OCC concludes that the final rule will not have a significant economic impact on a substantial number of small entities, the preamble to the final rule includes a certification statement, as described in Chapter II, with a brief reason why the certification is appropriate.

[19] Likewise, changes made in the final rule could result in the OCC concluding that an NPRM that did have a significant economic impact on a substantial number of small entities now, in final form, does not cross that threshold.

Agency certifications under the Reg Flex Act in final rules are subject to judicial review. Deficient certifications invite unnecessary litigation risk and may result in a final rule being remanded back to the OCC for additional Reg Flex analysis.

In the case of a regulation for which an IRFA was prepared, or for which a Final Regulatory Flexibility Analysis (FRFA) is otherwise required, the project manager prepares the FRFA, in consultation with PAD and the Regulatory Specialist. The project manager includes in the preamble a summary of the FRFA, together with a statement describing how copies of the complete analysis may be obtained, or the text of the complete FRFA. The complete analysis must be transmitted to the SBA's Office of Advocacy and made available to the public. As with agency Reg Flex Act certifications, FRFAs are subject to judicial review.

Pursuant to E.O. 13272, if the final rule is not eligible for certification under the Reg Flex Act, the Regulatory Specialist, in consultation with the project manager and the Assistant Director, notifies the SBA's Chief Counsel for Advocacy of the draft final rule "at a reasonable time" prior to its publication.

- Executive Order 13272 requires the OCC to "give every appropriate consideration" to comments provided by the SBA's Office of Advocacy on rules for which no Reg Flex Act certification has been provided and to respond in the preamble to the final regulation to questions raised by Advocacy.

Small Bank/Federal Savings Association Compliance Guide. For any final rule which is determined to have a significant impact on a substantial number of small entities and for which a FRFA is prepared, the SBREFA requires the OCC to publish one or more small business compliance guides to assist small entities in complying with the rule. This work need not be completed by the time the final rule is issued, but the project manager typically will begin work on the guide promptly after issuance of the final rule.

Congressional Review Act /Small Business Regulatory Enforcement Fairness Act

The Congressional Review Act, adopted as part of the SBREFA, generally provides a mechanism for Congressional review of agency regulations by requiring agencies to report to Congress and the General Accountability Office (GAO) when they issue a final rule and by establishing time frames within which Congress may act to disapprove a rule. To comply with the Congressional Review Act, the OCC must submit a Report to Congress and the GAO. The procedures for compliance with the Congressional Review Act are described at Step 9, below. As part of this Report, the OCC must state whether the rule is a "major rule" for Congressional Review Act purposes and must indicate whether the OCC prepared an analysis of costs and benefits.

The Congressional Review Act defines "major rule" to mean any rule that the Administrator of the Office of Information and Regulatory Affairs (OIRA) of the OMB finds has resulted in or is likely to result in: (1) an annual effect on the economy of $100,000,000 or more; (2) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or (3) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets. (5 U.S.C.

§ 804(2)(A)). In general, if a final rule is a "major rule," it may not take effect until the later of: (1) 60 days after the filing of the required reports to Congress or publication of the rule in the *Federal Register*, whichever is later; or (2) the date the rule would otherwise take effect unless a joint resolution of disapproval is enacted.

In order to determine whether the final rule is a major rule for purposes of the Report to Congress, the OCC must submit a request to OIRA for a major rule determination.

- Prior to this OIRA submission, LRA requests the Director of PAD's determination as to whether the rule is a "major rule" under this definition. This request should be made at the same time LRA requests the Director of PAD's determination under the Reg Flex Act and UMRA. (*See* Step 4, below.)

- This OIRA submission may be made via email, using the "Request for Major Rule Determination" form available on the LRA g:\ drive at g:\OCC Rulemaking Procedures. The submission is made by the Regulatory Specialist.

- The project manager must ensure that OIRA's decision has been received prior to submission of the final rule to the *Federal Register*, and must plan this submission accordingly.

Unfunded Mandates Act

The project manager updates the discussion of the UMRA in the preamble to the final rule based on new or updated analyses received from PAD, if any.

4. Coordinate Economic Analysis with PAD

The Director of PAD, in consultation with the Chief Counsel's Office, as appropriate, makes the determinations required pursuant to the Reg Flex Act, Congressional Review Act, and UMRA. PAD prepares the economic analyses necessary to support those determinations. Prior to distribution of the Gold Border package, the project manager sends a memorandum to PAD requesting an updated analysis of the final rule pursuant to the Reg Flex Act and the UMRA and a major rule determination under the Congressional Review Act. This memorandum indicates the differences between the proposed rule and the draft final rule and discusses any comments received relating to the applicable statutes and executive orders. The project manager sends this memorandum to PAD no later than the time of the distribution of the Gold Border package, requesting that PAD provide the project manager with its written response no later than the Gold Border comment due date. Whenever possible, particularly in the case of complex rulemakings, the memorandum to PAD should be sent at the earliest possible date.

- If the substance of a rule changes following receipt of PAD's revised analysis, the project attorney must request PAD to revise the analysis based on the changes and provide an updated analysis memorandum, approved by the Director of PAD, as soon as possible.

- The project manager must ensure that this updated analysis memorandum, in suitable form, adequately reviews the costs associated with the revisions to the proposed rule, and

contains the economic analyses necessary to support determinations required pursuant to the Reg Flex Act, Congressional Review Act, and UMRA.

5. Prepare and Distribute the Gold Border Package

The Gold Border package for the final rule consists of the same types of documents as the Gold Border package for the NPRM: draft final rule (regulatory text and preamble), the Gold Border Memorandum, and the Gold Border cover sheet. The distribution and review process are the same as for the Gold Border package for an NPRM. *See* Chapter II.

Gold Border Memorandum. The Gold Border memorandum contains a summary of the most significant provisions of the draft final rule, notes any changes made to the proposed rule, and describes any remaining issues raised by the public comments or by OCC (or interagency) staff.

Gold Border Cover Sheet. See the discussion of the Gold Border cover sheet in Chapter II.

6. Review and Address Gold Border Comments

The procedures for reviewing Gold Border comments are the same as for the NPRM. *See* Chapter II.

7. Prepare and Distribute the Red Border Package

The procedures for preparing and distributing the Red Border package are the same as for the NPRM. *See* Chapter II.

8. Coordinate Publication and Distribution of the Final Rule

For the most part, the procedures for publication and distribution of the final rule are the same as discussed in Chapter II for the NPRM. However, an additional step is required to comply with the Congressional Review Act once the final rule has been signed by the Comptroller.

9. Congressional Review Act/Small Business Regulatory Enforcement Fairness Act

The Congressional Review Act/SBREFA generally provides a mechanism for Congressional review of agency regulations by requiring agencies to report to Congress and the GAO when they issue final rules and by establishing time frames within which Congress may act to disapprove a rule.

- The project manager prepares the Report to Congress with the assistance of the Regulatory Specialist and **delivers the Report in person to the Speaker's Office and the President of the Senate's Office at the Capitol and obtains a signed receipt with the date, time, signature, and printed name of the receiving party at the respective offices.** This receipt is then included in the official file by the Regulatory Specialist. The Regulatory Specialist e-mails the report to the GAO on the same day. Delivery of this Report starts the clock for the Congressional review process. Accordingly, the project manager ensures that it is filed in a timely manner, usually on the same day as a final rule is published in the *Federal Register.*

- Three to four business days after delivery of the report, the project manager checks www.thomas.loc.gov to see if it has been officially received as reported in the Congressional Record for both the House and the Senate. If not, consult with LRA managers to determine appropriate follow-up.

- See Appendix III for specific procedures for filing this Report, and the LRA g:/ drive at g:\OCC Rulemaking Procedures for sample documents and forms.

10. Examiner View/OCC Supervisory Guidance Update

If the final rule amends an existing, or creates a new, possible violation of law, the project manager must provide the cite and a brief description of the revised/new violation to LRA's Examiner View (EV) Coordinator. The EV Coordinator will provide this new information to EV staff so that they may appropriately update EV.

- This information should be provided to the LRA EV Coordinator prior to the effective date of the new/revised violation.

In addition, the project manager must notify appropriate policy and/or supervisory staff of the final rule for any necessary revisions to OCC supervisory guidance. In most cases, this staff will be a member of the rulemaking working group.

PRACTICE TIPS

Docket Management – Public Comments

- Once the comment period has begun, the Project Attorney (or designee) must confirm that Regulations.Gov contains the rulemaking docket and is uploading comment letters to the correct docket.

- The project manager is responsible for reviewing the public comment process for the project docket to ensure public comments are accurately posted to O:\FR COMMENTS by Communications staff and to www.regulations.gov by LRA staff. After the close of the comment period, the project manager must compare both of these comment repositories for consistency and ensure that comments have been processed appropriately.

- Electronic copies of comments e-mailed to regs.comments@occ.treas.gov are directed to LRA.COMMENTPROCESSING@occ.treas.gov. The project manager must review or request that support staff or a regulatory specialist review the LRA.COMMENTPROCESSING@occ.treas.gov mailbox to ensure that there is not a backlog of e-mailed comments that have not been processed according to Appendix II: Comment Management Instructions.

- The project manager must ensure electronic copies of comments that are sent directly to www.regulations.gov are processed and provided to Communications as specified in Appendix II: Comment Management Instructions.

- The Communications Division scans and e-mails to LRA support staff public comments that are faxed or otherwise received by OCC in paper format. These comments are subsequently processed by LRA support staff or a regulatory specialist as specified in Appendix II: Comment Management Instructions.

- For a paper comment received directly by LRA, the project manager will ensure that the paper comment is scanned and uploaded to www.regulations.gov and that the paper comment is sent via interoffice mail to the Communications Division.

- LRA support staff will identify likely form letter public comments and consult with the project manager regarding where these comments should reside (e.g., network drive or e-mail folder). The project manager is responsible for managing the identification of duplicate comment letters, using specialized software if necessary,[20] and consulting with management regarding resources necessary for reviewing customized form letters ("near duplicates" form letters). These comments are subsequently processed by LRA support staff or a regulatory specialist following Appendix II: Comment Management Instructions.

- The project manager will consult with LRA management regarding public comments that are received in non-written form (*e.g.*, audio, video, physical objects).

[20] LRA is currently using DiscoverText software, which is available at www.discovertext.com.

Preparing and distributing the Gold Border package

- The project manager should insert the tracking number on the Gold Border cover sheet, with the initial designation "GB." Contact the Comptroller's Office, x4880, for the number. This number differs from the number provided for the NPRM.

- The project manager should prepare a redlined version of the final rule, showing changes made to the NPRM.

REFERENCES

- *See* REFERENCES section of Chapter II.
- For the procedural steps required to file the report to Congress pursuant to the Congressional Review Act, 5 U.S.C. § 804, *et seq.*, *see* Appendix III, and the Congressional Review Act memorandum on the LRA g:\ drive at g:\OCC Rulemaking Procedures.
- Sample documents including sample final rules, comment summaries, economic analyses, and FRFAs are available on the g:\ drive at g:\OCC Rulemaking Procedures.
- Templates for Red and Gold Borders are available in the "OCC Forms" section in the OCC's Word application. The project manager should consult with LRA staff for examples of recent final rules that could serve as a template.
- For effective date requirements, *see* § 302 of the Riegle Community Development and Regulatory Improvement Act of 1994, P.L. 103-325, 12 U.S.C. § 4802.
- For guidance on the Congressional Review Act, *see* Presidential Memorandum "Guidance for Implementing the Congressional Review Act", March 30, 1999 available on the LRA g:\ drive at g:\OCC Rulemaking Procedures.

CHAPTER IV – CLOSING THE RULEMAKING PROJECT: DOCUMENTATION AND RECORDKEEPING

The project manager is responsible for ensuring that a rulemaking project is closed in an orderly fashion and that the OCC's records reflect compliance with rulemaking procedures. LRA maintains a rulemaking file for each OCC rulemaking that contains significant documents in the rulemaking. Inclusion of a document in the rulemaking file does not determine whether it may, or must, be made public or be produced in response to a request under the Freedom of Information Act, a demand made during discovery in a litigated case, or other demand for information of the OCC. Such determinations are made on a case-specific basis in consultation with the Litigation Division, the Administrative and Internal Law Division, or the Communications Division, as appropriate.

PROCEDURES

1. Complete the Rulemaking Checklist

A rulemaking checklist is maintained for each rulemaking. The checklist contains the key steps in the rulemaking process. The project manager indicates on the checklist the date on which each step is completed. At the conclusion of a rulemaking project, the project manager transmits the checklist to the Regulatory Specialist for inclusion in the rulemaking file. The checklist is maintained in the rulemaking file.

2. Complete the Rulemaking File

The Regulatory Specialist is responsible for maintaining and keeping the rulemaking file for each rulemaking. Upon completion of the rulemaking, the project manager works with the Regulatory Specialist to ensure that the key rulemaking documents are included in the file. Once the rulemaking file is complete, the Regulatory Specialist uploads the file to CCORe.
The rulemaking file contains the following documents:

- Any project initiation memorandum;
- Any issues memorandum;
- Memoranda submitted to PAD requesting economic analysis of the proposed and final rules, and memoranda received from PAD containing such analysis;
- If separately prepared, any regulatory impact analysis, initial or final regulatory flexibility analysis, or similar analysis conducted pursuant to a requirement in a statute or executive order;
- The Gold Border Reviewers' Memorandum, cover sheet, and the Gold Border draft of the proposed and final rules;
- The Red Border Memorandum, cover sheet, and the Red Border draft of the proposed and final rules;
- The proposed and final rules as submitted to the *Federal Register;*
- Any correspondence to or from OMB regarding the proposed or final rule, including e-mails;
- Any correspondence, other than a comment letter, to or from any other Federal agency, State or local government official, or associations or representatives of State or local government officials;

- The proposed and final rules as published in the *Federal Register;*
- The report to Congress and delivery receipts (for final rules only);
- A list of public comments received during the rulemaking;
- Any comment summaries prepared in connection with the rulemaking;
- Any public comments filed by OMB under the PRA regarding collections of information contained in the rule (the Regulatory Specialist maintains a separate file for the PRA filing documents);
- The press release, if any;
- The OCC Bulletin; and
- The rulemaking checklist;

3. File Completion Form

Once the rulemaking file is complete, the Regulatory Specialist completes and signs the Regulatory Specialist File Completion Form, in which he or she indicates that he or she has reviewed the rulemaking checklist and all relevant checklist items have been completed and that the agency rulemaking file is complete. *See* Appendix IV or the LRA g:\ drive at g:\OCC Rulemaking Procedures.

Appendix I

Policy Analysis Division, Economics Department

Standard procedures for economic analysis of proposed rules[1]
(Revised 10/18/11)

1. Legislative and Regulatory Activities (LRA) project attorney contacts the Policy Analysis Division (PAD) Director to discuss the rule and/or provide PAD with documentation (e.g., an issues memorandum for OCC discretionary rulemakings) and request assignment of PAD staff to the project.
2. PAD Director[2] reviews the LRA request and assigns the task to a PAD staff member. The extent of PAD staff involvement in the rulemaking process after the PAD Director assigns staff to the project -- but before the LRA project attorney provides a formal request for analysis -- will vary based on, among other things, the circumstances prompting the rulemaking.
3. LRA project attorney sends assigned PAD staff and the PAD Director a draft rule and a memo requesting economic analysis that, among other things, identifies mandates in the rule.
4. If necessary, PAD staff requests copies of background or supporting material that LRA may have collected as part of the rule-writing process from the LRA project attorney.[3]
5. PAD staff prepares a preliminary impact assessment that:[4]
   a. Describes the rule and its requirements;
   b. Identifies the institutions that will be affected by the rule;
   c. Estimates the likely impact of the rule; and,
   d. Assesses the likely impact on small institutions in accordance with the requirements of the Regulatory Flexibility Act (RFA).
6. PAD staff determines if the estimated costs of the rule will:
   a. Result in expenditures of $100 million or more annually by state, local, and tribal governments, or by the private sector as required by the Unfunded Mandates Reform Act of 1995 (UMRA);[5] and,
   b. Have a significant economic impact on a substantial number of small entities (pursuant to the RFA).
7. PAD staff then completes the following tasks as necessary:

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[1] The procedures in this document apply to requests for analysis that the PAD Director receives after September 15, 2011.
[2] We use "PAD Director" to refer to the director or the director's designee.
[3] If the rulemaking began with an advance noticed of proposed rulemaking (ANPR), LRA should provide PAD staff with any comment summaries prepared by staff in LRA or at another agency (provided the other agency sends LRA staff a copy of the summary).
[4] For guidance on preparing an analysis of a significant rule, see step 8 and OMB Circular A-4.
[5] In these procedures, we refer to rules with cost estimates at or above the criteria described in this step as "significant" and rules with estimated costs below the criteria as "not significant."

i. If 6(a) and 6(b) are false, then skip to step 10.

a. If 6(a) is true, then complete steps 8 and 10.

b. If 6(a) and (b) are true, then complete steps 8 through 10.

c. If 6(b) is true, then complete steps 9 and 10.

8. If the PAD staff preliminary analysis concludes that the impact of the rule is significant (i.e., above the UMRA threshold) then:

a. PAD staff prepares a full cost-benefit analysis that, at a minimum, includes the elements in a cost assessment of a proposed rule that is not significant and adds the following elements:

i. A statement of the need for the proposed regulatory action (for guidance, see Circular A-4, pages 1-6),

ii. A qualitative or quantitative assessment of the benefits of the proposed rule (for suggestions regarding methods for treating non-monetized benefits and costs, see Circular A-4 pages 26-28),

iii. A comparison to the baseline, which is the state of the world in the absence of the proposed rule, and

iv. A comparison to one or more plausible alternatives to the proposed rule (for suggested alternative regulatory approaches, see Circular A-4, pages 7-9).[6]

b. PAD staff sends the draft to the PAD director for comment and upon approval from PAD director,

c. PAD staff circulates the draft assessment memo for comments and suggestions to the LRA project attorney and the subject matter expert(s).[7]

9. If the preliminary assessment is that the rule will have a significant economic impact on a substantial number of small entities, PAD staff will:

a. Consult with the project attorney if PAD staff is not already aware of alternatives for small entities evaluated by LRA staff (before the request for analysis was sent to PAD); and,

b. Prepare analysis necessary to comply with the RFA; or,

c. If additional information is required, prepare questions that LRA may include in the proposed rule to solicit input for analysis of the impact of the final rule on small entities.[8]

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[6] If possible, when rulemakings are required by statute, the baseline or one of the alternatives should include the statutory requirements but exclude mandates in the rule that are not required by statute. Analysis of the statutory requirements will be useful when preparing analysis of the final rule to comply with the Congressional Review Act (CRA).

[7] The subject matter expert is staff or management in the OCC department most closely related to the implementation of the rule. In some cases, the PAD Director may opt to review the draft assessment memo before PAD staff circulates it to staff in other divisions.

[8] For guidance on the RFA, PAD staff may refer to the Small Business Administrations, Office of Advocacy's *Guide for Government Agencies.*

10. After incorporating comments (if any) PAD staff sends a draft final memo to the PAD Director, and the PAD Director either:
    a. Approves and distributes the memo; [9] or,
    b. Directs PAD staff to revise the memo and then resubmit it to the Director for approval and distribution.
11. As circumstances warrant, LRA (either the project attorney or a manager) will inform PAD staff and the PAD Director of significant changes made to the draft rule that PAD used to prepare the analysis memorandum and shall request an updated and revised memorandum. After consulting with the PAD Director, PAD staff will prepare an updated analysis memorandum for the Director's review and approval.
12. LRA will ensure that this updated analysis memorandum, in a suitable form, adequately reviews the costs associated with the revisions to the proposed rule and contains the economic analysis necessary to support the required determinations under the RFA and UMRA.

Standard procedures for economic analysis of final rules

1. LRA project attorney contacts the PAD Director (and staff that drafted the analysis memo for the NPRM) and provides documentation (e.g., a comment summary and/or the draft final rule).[10]
2. See procedures for proposed rules. Repeat steps 3 through 5 for the draft final rule and incorporate analysis required by the Congressional Review Act (CRA) and relevant information (if any) obtained from the public and/or regulated entities.
    a. If the draft final rule does not exceed any of the thresholds listed in the CRA or the UMRA, and it does not have a significant economic impact on a substantial number of small entities, repeat step 10.
    b. If the draft final rule does not exceed any of the thresholds listed in the CRA or the UMRA and it does have a significant economic impact on a substantial number of small entities, repeat steps 9 and 10.
    c. Otherwise, repeat steps 8 through 10 incorporating relevant information obtained from the public and/or regulated entities.
3. If necessary, repeat step 11.

[9] The PAD Director sends the analysis memo is to the LRA project attorney with a copy to (a) at least one LRA manager and (b) LRA staff responsible for preparing estimates required by the Paperwork Reduction Act (PRA).
[10] If necessary, the PAD director will inform the project attorney if there are any changes to PAD staff assigned to the project.

Appendix II

Comment Management Instructions

1. Check LRA.COMMENTPROCESSING@occ.treas.gov inbox for new comments.
2. Delete spam.
3. Highlight all new comments.
4. Click ADOBE PDF in toolbar.
5. Click "Convert Selected Messages."
6. Click "Create New PDF."
7. Save File in any location (it can be deleted at the end of this process).
8. In PDF file, highlight one comment letter at a time, go to File->Save Files from Portfolio.
9. Save files in G:\Comment Letters\DOCKET\.
10. Delete file from PDF portfolio.
11. Repeat steps 8-10 until all comment letters have been processed.
    a. If it is obvious that certain comment letters are form letters, then multiple comments can be highlighted and saved to G:\Comment Letters\DOCKET\NAME OF FORM LETTER.
    b. If the email is saved to a form letter folder, make certain that the files are numbered.
12. Mark email as read and/or delete email.
13. Upload comments to FDMS (only upload one example of each identical duplicate form letter and list a count of the form letters in the title of each form comment letter type in the FDMS entry).
    a. Instructions for one document at a time:
        i. On FDMS inbox page (the default start page) click on the appropriate docket.
        ii. Click on "Add Document" in top right corner of the page.
        iii. Fill in all the required information and submitter name, organization, city, and state if possible.
        iv. Upload comment.
        v. Post comments that do not include confidential business information, customer account information, or other sensitive information. Refer comments not posted to the project manager for review and direction on whether to post.
    b. Instructions for multiple documents:
        i. On FDMS inbox page (the default start page) locate appropriate docket and bulk import image. It is the image at the far right of an arrow pointing to a file folder.
        ii. Add the saved comment letters.
        iii. Fill out comment names.

iv. On FDMS inbox page (the default start page) click on the appropriate docket.
v. Go through comments and fill in all the required information and submitter name, organization, city, and state, if possible.
vi. Only post comments that do not include confidential business information, customer account information, or other sensitive information. Refer comments containing such information to the project manager for review and direction on whether to post.

c. Move files to G:\Comment Letters\DOCKET\Processed.

14. Check FDMS website for new comments:
    a. On inbox page (the default start page) change search parameters to "Documents" "assigned to me" "created" Within the past "6" "days" with a status of "Nonpublic."
        i. If you have not checked comments within that time frame, then expand to the necessary number of days.
    b. Check all documents to be exported.
    c. Click export.
    d. Click "Download Export File."
    e. Open file with "WinZip."
    f. Extract files to G:\Comment Letters\DOCKET\Processed.
    g. Rename file to reflect the submitter.
    h. Email files to Communications staff.

Only post comments that do not include confidential business information, customer account information, or other sensitive information. Refer comments containing such information to the project manager for review

Appendix III

Procedures for Preparing a Report to Congress

1. Fill out the Report to Congress form, save, and name the file REPORTTOCONGRESS [RIN number].pdf (the RIN number can be found at the top of the published Federal Register document). The LRA Regulatory Specialist is the submitter of the report-- you need to put this on the form if it's not there already.

2. Prepare a short summary of the final rule in MS Word. The summary of the rule from the Federal Register document may be used for this purpose. Save and name this file REPORTTOCONGRESSSUMM [RIN number].doc.

3. Prepare the attached transmittal letter for the Report to Congress and name the file REPORTTOCONGRESSTRANSMITTAL [RIN number].doc. The transmittal letter will go out under the LRA Regulatory Specialist's name.

4. E-mail the three files from steps 1, 2, and 3 above to the LRA Regulatory Specialist, who will review the Report to Congress form, summary, and the transmittal letter. He/she will work with the project manager to make any necessary changes.

5, When all is in order, the LRA Regulatory Specialist will sign **three originals** of the Report to Congress and 3 transmittal letters (one **original** for the President of the Senate, one **original** for the Speaker of the House, and one **original** for GAO).

6. The LRA Regulatory Specialist will return the signed originals to the project manager.

7. The project manager must fill out the attached Receipt for Submission of a Federal Rule Under the Congressional Review Act.

8. Assemble the Report to Congress package in the following order from top to bottom: receipt for submission, transmittal letter, **original signed** Report to Congress Form, summary of rule, and a copy of the final rule as published in the *Federal Register*.

9. Make a copy of each assembled package for the rulemaking file and provide the copies to the LRA Regulatory Specialist.

10. The project manager will give the LRA Regulatory Specialist the ***original*** package addressed to GAO. The Regulatory Specialist will scan and e-mail the report to GAO.

11. **The project manager must deliver the Report to Congress in person to the Speaker's Office and the President of the Senate's office at the Capitol and receive a signed receipt with the date, time, signature, and printed name of the receiving party at the respective offices.**

12. Three to 4 business days after you have delivered the Report to Congress, start checking to see if it has been officially received as reported in the Congressional Record online for both the HOUSE and the SENATE using a term and date-range search at this link:

http://thomas.loc.gov/home/r108query.html (Note: this link is only going to be good for the 108th Congress, when a new Congress is installed, the link will change. Check http://thomas.loc.gov/home/thomas.html for updated links.) Please note that there can be a significant delay between delivery of the documents and publication in the Congressional Record. In some cases, it may be necessary to call the Committees or the House and Senate clerks to confirm official receipt.

Appendix IV

Regulatory Specialist File Completion Form

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

TITLE OF RULEMAKING: _____

CFR PARTS: _____ RIN: _____

PUBLICATION DATE OF FINAL RULE: _____

I HAVE REVIEWED THAT ATTACHED RULEMAKING CHECKLIST FOR THIS RULEMAKING. ALL RELEVANT CHECKLIST ACTIONS HAVE BEEN COMPLETED AND THE AGENCY RULEMAKING FILE IS COMPLETE.

_____ [SIGNATURE]

[INSERT NAME]
LRA REGULATORY SPECIALIST

Date: _____

Appendix V

LRA RULEMAKING CHECKLIST

TITLE OF RULEMAKING: _____

CFR PARTS: _____

RIN: _____

PROJECT MANAGER: _____

Working Group Members:

_____ _____

_____ _____

_____ _____

_____ _____

_____ _____

_____ _____

_____ _____

_____ _____

_____ _____

_____ _____

ACTION	DATE	INITIALS	COMMENTS
I. Project Initiation			
• Project initiation memo prepared, if necessary			
• Issues memo prepared, and circulated, if necessary			
• First working group meeting held, if necessary			
• **Policy Analysis Division (PAD) contacted**			
II. Proposed Rule (NPRM)			
• Proposed rule drafted and circulated to working group for review			
• Gold border memo and cover sheet prepared			
• Gold border package signed and approved for distribution by Chief Counsel, and Executive Committee co-sponsor, if applicable ☐ Gold border number: _____			
• Gold border package distributed to reviewers ☐ Comments due on _____ ☐ Comments received from all reviewers ☐ Electronic version of Gold Border package sent to Comptroller's Office			
• Memo sent to PAD requesting economic analysis pursuant to Reg Flex Act and Unfunded Mandates Reform Act			
• Memo received from PAD containing economic analysis pursuant to Reg Flex Act and Unfunded Mandates Reform Act			
• Paperwork Reduction Act (PRA) analysis prepared ☐ Preamble language drafted ☐ Documentation of our analysis (information about how decisions were reached, who was consulted, and their views) included in file			
• Reg Flex Act analysis prepared ☐ If not exempt, certification of no significant impact drafted **OR** ☐ SBA notified, and Initial Reg Flex analysis (IRFA) sent to SBA for review ☐ Preamble language drafted ☐ Documentation of our analysis included in file			

ACTION	DATE	INITIALS	COMMENTS
• Unfunded Mandates Reform Act analysis prepared ❑ Budgetary impact statement prepared, if necessary ❑ Preamble language drafted ❑ Documentation of our analysis included in file			
• Final version of NPRM prepared and circulated for review			
• Red border memo and cover sheet prepared			
• PAD contacted, via memo, to review economic analysis if substantive changes made to NPRM based on Gold Border comments			
• Public Relations notified of upcoming publication ❑ Draft press release and/or Q&As, if necessary			
• Red Border package approved by Chief Counsel, and Executive Committee co-sponsor, if applicable			
• Red border package sent to Comptroller for signature			
• SBA's comments on IRFA pursuant to Reg Flex Act, received and incorporated into NPRM before publication, if applicable			
• Comptroller's signature obtained			
• PRA clearance package submitted to OMB, if applicable, on or before date published in *Federal Register*			
• Chief Counsel's approval to send to *Federal Register* obtained			
• Final NPRM sent to *Federal Register*			
• Document published in *Federal Register* Comment period ends on _____			
• *Federal Register* version of NPRM distributed to OCC interested parties			
• OCC Bulletin prepared and sent to Communications for review ❑ Draft distributed on green border			
• OCC Bulletin signed by Chief Counsel, and Executive Committee co-sponsor, if applicable			

ACTION	DATE	INITIALS	COMMENTS
• Electronic copy of *Federal Register* document and final OCC Bulletin and hard copy of Green Border cover sheet (with reviewers' initials) and Bulletin signed by Chief Counsel and Executive Committee co-sponsor, if applicable, sent to Communications			
• Final OCC Bulletin distributed by Communications			
• *Federal Register* version of NPRM proofread and *Federal Register* is notified of any errors			
• Regulations.Gov checked to confirm rulemaking docket exists and is uploading comment letters to the correct docket.			
III. FINAL RULE			
• The O:\ Drive (O:\FR COMMENTS) and www.regulations.gov compared and reviewed for consistency □ All comments processed appropriately			
• Public comments reviewed and comment summary prepared □ Comment summary sent to Chief Counsel, Executive Committee co-sponsor, if applicable, and working group for review			
• Final rule drafted and circulated for review			
• Gold Border memo and cover sheet prepared			
• Gold Border package signed and approved for distribution by Chief Counsel, and Executive Committee co-sponsor, if applicable □ Gold Border number: _____			
• Gold border package distributed to reviewers □ Comments due on _____ □ Comments received from all Gold Border Reviewers			
• Electronic version of Gold Border package sent to Comptroller's Office			
• OMB PRA comments/approval received, if applicable			
• Memo to PAD requesting economic analysis of final rule pursuant to Reg Flex Act, Unfunded Mandates Reform Act and Congressional Review Act (CRA)/Small Business Regulatory Enforcement Fairness Act (SBREFA) prepared and sent			

ACTION	DATE	INITIALS	COMMENTS
• Memo received from PAD containing economic analysis pursuant to the Reg Flex Act, Unfunded Mandates Act, and CRA/SBREFA			
• PRA analysis prepared if information collection in rule has changed or to reflect OMB comments ❑ Preamble language updated, if necessary			
• Reg Flex Act analysis updated, if necessary ❑ Certification of no significant impact drafted **OR** ❑ Final Reg Flex analysis (FRFA) sent to SBA for review ❑ Preamble language updated, if necessary			
• Unfunded Mandates Reform Act analysis updated ❑ Preamble language updated, if necessary			
• CRA/SBREFA analysis prepared			
• Final version of final rule prepared and circulated to working group for review			
• Red Border memo and cover sheet prepared			
• PAD contacted, via memo, to review economic analysis if substantive changes made to final rule based on Gold Border comments			
• Public Relations notified of upcoming publication ❑ Draft press release and/or Q&As, if necessary			
• Red Board package approved by Chief Counsel and Executive Committee co-sponsor, if applicable			
• SBA's comments on FRFA pursuant to Reg Flex Act received and incorporated into final rule before publication, if applicable			
• Red Border package sent to Comptroller for signature			
• Comptroller's signature obtained			
• PRA clearance package submitted to OMB, if applicable, on or before date rule published in *Federal Register*			
• OCC Bulletin prepared and sent to Communications for review ❑ Draft distributed on green border			

ACTION	DATE	INITIALS	COMMENTS
• Chief Counsel's approval to send rule to *Federal Register* obtained			
• Final rule sent to *Federal Register*			
• Document published in the *Federal Register* on ___ ❑ Effective Date_____			
• Report to Congress prepared and hand-delivered by project manager or Regulatory Specialist to: ❑ Senate Banking Committee via Appointments Desk (delivery receipt obtained and placed in official rulemaking file) ❑ House Financial Services Committee via the Speaker's Office (delivery receipt obtained and placed in official rulemaking file) ❑ GAO (fax receipt obtained and placed in official rulemaking file)			
• *Federal Register* version of rule distributed to OCC interested parties			
• OCC Bulletin signed by Chief Counsel and Executive Committee co-sponsor, if applicable			
• Electronic copy of *Federal Register* document and final OCC Bulletin and hard copy of Green Border cover sheet (with reviewers' initials) and Bulletin signed by Chief Counsel and Executive Committee co-sponsor, if applicable, sent to Communications			
• OCC Bulletin distributed by Communications			
• Published version of final rule proofread and *Federal Register* notified of any errors			
• Small bank compliance guide prepared pursuant to Reg Flex Act, if necessary			
• Summary of new or amended violation of law, with cite(s) sent to Examiner View (EV) Coordinator prior to effective date			
• Appropriate Policy/Supervisions staff notified of final rule for any necessary revisions to OCC supervisory guidance.			
• Congressional Record checked to confirm Senate and House receipt of Report to Congress			

IV. Project Closing			
• Rulemaking checklist provided to Regulatory Specialist □ Regulatory Specialist signs-off on completeness check			
• Lotus Notes entry closed			
• Official rulemaking file organized and closed			
• Regulatory Specialist uploads rulemaking file to CCORe.			

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

November 29, 2011

Mr. Cass Sunstein
Administrator
Office of Information and Regulatory Affairs
Office of Management and Budget
725 17th Street, NW
Washington, DC 20503

Dear Mr. Sunstein:

I am writing to follow up on our conversation about the ongoing efforts of the Office of the Comptroller of the Currency (OCC) to increase regulatory effectiveness and reduce regulatory burden, consistent with the goals of Executive Order 13563. This letter highlights key aspects of our work in this regard. Most importantly, the OCC currently is reviewing all of its regulations for the purpose of integrating the rules governing Federal savings associations into the rules for national banks. As part of this comprehensive review program, we plan to seek public comment about ways to improve each of our rules to promote efficiency and reduce burden as we prepare the final, integrated rulebook. In addition, although Executive Order 13563 does not apply to the OCC by its terms, our agency is subject to a statutory requirement unique to the Federal banking agencies, pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA)[1] that imposes regulation review requirements similar in scope and purpose to those in the Executive Order. We completed the last review over a period that ended December 2006, and, as the statute requires, we will complete the next EGRPRA review not later than 2016.

The OCC recognizes the importance of reviewing its rules to reduce unnecessary regulatory burden and is addressing that goal on a number of fronts. For example, Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act[2] (Dodd-Frank Act) transferred to the OCC all the functions of the Office of Thrift Supervision (OTS) and the Director of the OTS related to Federal saving associations, as well as OTS rulemaking authority related to both state and Federal savings associations. In connection with this transfer, the OCC has undertaken a comprehensive review of both OCC and OTS regulations to make them more effective by combining them where possible, reducing duplication, and eliminating unnecessary requirements.

[1] Pub. L. No. 104-208, § 2222, 110 Stat. 3009, 3009-414 (Sept. 30, 1996), codified at 12 U.S.C. § 3311.
[2] Pub. L. No. 111-203 (July 21, 2010).

On May 26, 2011, in a *Federal Register* publication, we proposed revisions to OCC and OTS rules that relate to internal agency functions and operations and that implement certain provisions of the Dodd-Frank Act.[3] As the proposal stated, this issuance was part of the OCC's review of national bank and savings association regulations "to determine what changes [were] needed to facilitate a smooth regulatory transition."[4] The final rule was published on July 21, 2011,[5] the date on which OTS functions officially transferred to the OCC.

Shortly thereafter, in order to facilitate the OCC's administration and enforcement of the OTS rules and to make appropriate changes to these rules to reflect the OCC's supervision of Federal savings associations, the OCC republished as its own the former OTS regulations with nomenclature and other minor changes.[6] Recognizing this republication as the next, but not the final, step in the OCC's integration process, the republication notice stated that, going forward:

> [T]he OCC will consider more comprehensive substantive amendments, as necessary, to the Republished Regulations. For example, we may propose to repeal or combine provisions in cases where OCC and former OTS rules are substantively identical or substantially overlap. In addition, we may propose to repeal or modify OCC or former OTS rules where differences in regulatory approach are not required by statute or warranted by features unique to either the national bank or Federal savings association charter. This substantive review also will provide an opportunity for the OCC to ask for comments suggesting revisions to the rules for both national banks and Federal savings associations that would remove provisions that are "outmoded, ineffective, insufficient, or excessively burdensome," consistent with the goals outlined in [Executive Order 13563].[7]

Consistent with this statement, OCC staff is currently undertaking a substantive review of all national bank and Federal savings association regulations in an effort to consolidate, where statutorily permissible and consistent with safety and soundness, two distinct sets of regulations (those of national banks and those of savings associations) into a single, streamlined set. In this effort, the OCC is also specifically seeking to identify regulations that are "outmoded, ineffective, insufficient, or excessively burdensome." We will then publish, as one or more Notices of Proposed Rulemaking, revised rules on which industry and the public can comment. After careful consideration of these comments, the OCC will issue a final rule.

As noted above, the OCC also is subject to EGRPRA, which requires the Federal Financial Institutions Examination Council (FFIEC) and each Federal banking agency to review its regulations every 10 years. The purpose of this review is to identify outdated or otherwise unnecessary regulatory requirements. This joint exercise provides the banking agencies with the opportunity to consider how to streamline the regulatory process for the financial institutions we regulate.

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[3] 76 Fed. Reg. 30557 (May 26, 2011).
[4] Id., at 30558.
[5] 76 Fed. Reg. 43549 (July 21, 2011).
[6] 76 Fed. Reg. 48950 (Aug. 9, 2011).
[7] Id., at 48951.

The OCC and the other Federal banking agencies began their most recent EGRPRA review in June 2003. Over a three-year period ending in December 2006, the agencies received public comments on over 130 regulations, carefully analyzed these comments, and proposed changes to their regulations, all with the goal of eliminating burden where possible. A final report was submitted to Congress on July 31, 2007. The next EGRPRA review is due to be completed in 2016. At the conclusion of the EGRPRA review, the final report will be submitted to Congress and made available to the public.

The OCC encourages and considers public comments concerning the impact of the rules we issue. We undertake analyses of costs and benefits consistent with the requirements of several statutes. Under the Paperwork Reduction Act,[8] the OCC assesses the anticipated cost of any paperwork associated with its regulatory provisions. Under the Congressional Review Act,[9] the OCC provides to Congress and others any cost-benefit or other impact analyses prepared as part of a final rulemaking. Under the Regulatory Flexibility Act,[10] the OCC conducts an analysis of any rule likely to have a significant economic impact on a substantial number of small entities. This includes, of course, small community banks.

In addition, the OCC's ongoing work with the other Federal financial regulatory agencies helps avoid duplication and promotes consistency in regulatory and supervisory approaches. As you know, the OCC participates in the Financial Stability Oversight Council and the FFIEC. In addition to these principal-level contacts, OCC staff – ranging from senior deputy comptrollers to staff members participating in interagency working groups – are in frequent contact with their counterparts at the other banking agencies and, increasingly, with the other financial sector regulators with whom we share implementation responsibilities for the Dodd-Frank Act. These less formal interactions provide multiple channels for coordinating efforts to facilitate consistent and comparable regulation, as appropriate in light of the structure and activities of the institutions under our respective jurisdictions.

As another way of gaining insight into how our regulations and other actions affect the Federal savings associations that were transferred to our supervision effective in July 2011, the OCC is carrying on the work of two advisory committees that the OTS had administered, the Mutual Savings Association Advisory Committee (MSAAC) and the Minority Depository Institutions Advisory Committee (MDIAC). With respect to the MSAAC, the OCC believes it is necessary and in the public interest for it to study the needs of and challenges facing mutual savings associations. With respect to the MDIAC, the OCC seeks to preserve the present number of minority depository institutions and to encourage the creation of new ones.[11]

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[8] 44 U.S.C. § 3501 *et seq.*
[9] 5 U.S.C. § 801 *et seq.*
[10] 5 U.S.C. § 601 *et seq.*
[11] With respect to both committees, the OCC is currently seeking nominations for persons to serve as committee members. Notices seeking nominations were published in the Federal Register. *See* 76 Fed. Reg. 71437 (Nov. 17, 2011) and 76 Fed. Reg. 71438 (Nov. 17, 2011).

Consistent with the Administrative Procedure Act (APA),[12] the OCC strongly encourages the public to participate in the rulemaking process. The OCC generally provides the public with at least a 60 day comment period for each proposed rulemaking and details numerous channels through which comments can be submitted. The OCC solicits comments on the regulatory burden associated with a proposal and encourages feedback on how any burden could be reduced. The agency values this feedback and carefully considers all the comments we receive as we formulate a final rule.

Finally, apart from any statutorily mandated regulatory review, the OCC has a longstanding and demonstrated commitment to regulation review. For example, during the mid-1990s (and prior to the enactment of EGRPRA), the OCC engaged in a three-year, top-to-bottom review of all of its regulations in a successful effort to streamline its regulatory process.[13] Consistent with this agency culture, the OCC views the integration of the national bank and savings association rules discussed above, along with all of its other interactions with the public, industry, and other agencies, as opportunities to inform its decisions to achieve rules that are both effective and efficient.

We appreciate the opportunity to share with you our on-going regulatory review efforts. Please do not hesitate to contact me if you have any questions.

Sincerely,

John Walsh
Acting Comptroller of the Currency

[12] 5 U.S.C. § 551 *et seq.*

[13] Since this time, the overwhelming majority of the regulations that the OCC has issued have been promulgated in response to an explicit congressional mandate. In these situations, the agency's discretion is limited by the parameters that Congress sets forth.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

BEN S. BERNANKE
CHAIRMAN

February 9, 2012

The Honorable Tim Johnson
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This is in reply to your letter of November 9, 2011, regarding the importance of conducting an evaluation of the costs and benefits of rulemakings conducted by the Federal banking regulators under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). The attached responses provide detail about our efforts to assess the benefits and costs of rules.

As your letter points out, Congress enacted the Dodd-Frank Act to address a number of deficiencies that contributed to the worst financial crisis in many years for the U.S. and to enhance protections for consumers, investors and taxpayers. It is critical that the agencies, including the Federal Reserve, implement this Act in a thoughtful manner that gives full effect to the Congressional intent behind the statute and does so in a manner that responsibly balances the costs and benefits of our implementation efforts.

In this spirit, let me assure you that the Federal Reserve takes quite seriously the importance of evaluating the burdens imposed by our efforts to issue rules implementing the Dodd-Frank Act and adopting an approach that balances costs and burdens within the requirements of each statutory mandate. We do this in a variety of ways, and at several different stages in the regulatory process.

For example, before the Federal Reserve develops a regulatory proposal, we often collect information through surveys and meetings directly from the parties that we expect will be affected by the rulemaking. This helps us to become informed about the benefits and costs of the proposed rule and craft a proposal that is both effective and minimizes regulatory burden. During the rulemaking process, we also specifically seek comment from the public on the benefits and costs of our proposed approach as well as on a variety of alternative approaches to the proposal. In adopting the final rule, we aim for a regulatory alternative that faithfully reflects the statutory provisions and the intent of Congress while minimizing regulatory burden. We also provide an analysis of the costs

to small organizations of our rulemaking consistent with the Regulatory Flexibility Act and compute the anticipated costs of paperwork consistent with the Paperwork Reduction Act.

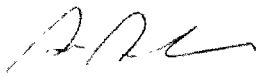
Measuring the impact of agency regulations on affected persons and the overall economy is very challenging, especially in the context of the numerous related rules required by the Dodd-Frank Act to be issued during the same time period by a number of agencies. The Federal Reserve believes strongly that public comment can enlighten our regulatory actions and inform our implementation of our statutory responsibilities. Consequently, the Federal Reserve has long followed the practice of providing the public a minimum of 60 days to comment on all significant rulemaking proposals, with longer periods permitted for especially complex or significant proposals, such as our recent proposal on enhanced prudential standards. We also have extended the comment period in cases where we believe additional time helps to promote the public's interest, such as in the case of the Volcker Rule and risk retention proposals. Similarly, we also favor seeking public comment on significant statements of regulatory guidance, and typically invite the public to comment on major statements of supervisory guidance, such as our guidance regarding incentive compensation. In addition, we make available to the public our examination manuals, supervisory letters, transaction approvals (and denials), and other matters of interest to the public related to implementation of our statutory responsibilities.

We also consult regularly with our fellow bank regulatory agencies on matters that might affect their institutions as well as on matters of common interest where a single regulatory approach across banking organizations of different charters would reduce compliance burden and risk. We accomplish this in many ways. The Federal Reserve participates in the Federal Financial Institutions Examination Council and in the Financial Stability Oversight Council, both of which facilitate interagency consultation and cooperation. Moreover, members of the Board as well as staff at senior levels have long established working associations with their peers at other agencies and have regular meetings to discuss policies of common interest and applicability. These many avenues of consultation at multiple levels increase the coordination and consistency of regulation across a banking industry that has many regulators and charters. We have expanded these channels to include regular consultation with the SEC, CFTC, CFPB and other agencies as changes in the law have caused our spheres of regulatory responsibilities increasingly to overlap.

The Federal Reserve also has for many years had a policy of conducting a zero-based review of each of its regulations on a periodic basis--typically every five years. The purpose of this review is to update each rule, reduce unnecessary burden, and streamline regulatory requirements based on our experience in implementing the rule and where permitted by the authorizing statutory provisions that motivated the rule.

Through these steps, more fully explained in the attached responses, the Federal Reserve seeks to carry out our statutory duties in a manner that is both consistent with the legislation enacted by Congress and maximizes benefits and minimizes costs associated with our implementation efforts.

Sincerely,



Enclosure

Attachment

1. Provide a detailed description of your agency's rulemaking process, including the variety of economic impact factors considered in your rulemaking. Please note to what degree you consider the benefits from your rulemaking, including providing certainty to the marketplace and preventing catastrophic costs from a financial crisis. Also describe any difficulties you may have in quantifying benefits and costs, as well as any challenges you may face in collecting the data necessary to conduct economic analysis of your rulemaking.

For every new regulation put forth by the Federal Reserve alone or jointly with other agencies, including those promulgated under the Dodd-Frank Act, it is the policy of the Federal Reserve to consider the various options available consistent with the statutory mandate being implemented; analyze the possible economic impact of implementing proposals to the extent permitted by available data; evaluate the compliance, record-keeping, and reporting burdens; and recommend the best course of action consistent with the statutory mandate based on an evaluation of the alternatives. If the regulation concerns an area where considerable information is available, a correspondingly more exhaustive regulatory analysis will be undertaken. For significant Dodd-Frank regulations, we assemble interdisciplinary teams, bringing together economists, supervisors, legal staff, and other specialists to help develop sensible policy alternatives and to help avoid unintended consequences. During the proposal stage, we specifically seek comment from the public on the costs and benefits of our proposed approach through surveys and meetings, as well as on alternative approaches to our proposal. This helps us to become informed about the benefits and costs of the proposed rule and craft a proposal that both is consistent with the Congressionally established mandate and minimizes regulatory burden. In adopting the final rule, we aim for a regulatory alternative that faithfully reflects the statutory provisions and the intent of Congress while minimizing regulatory burden. In addition, the Board is subject to two laws that require specific types of analysis--the Paperwork Reduction Act ("PRA") and the Regulatory Flexibility Act ("RFA"). The PRA and RFA require evaluations of the rulemaking's paperwork burden and effect on small entities, respectively. The Federal Reserve includes a separate analysis under each of these laws in its rulemaking publications.

Federal financial regulators face considerable challenges in quantifying all potential benefits and costs of a particular rule, such as the benefits from marketplace certainty or the prevention of a future financial crisis, especially in the context of the numerous related rules required by the Dodd-Frank Act to be issued during the same time period by a number of agencies. The GAO recently noted that the difficulty of reliably estimating the costs of regulations to the financial services industry and the nation has long been recognized, and the benefits of regulation generally are regarded as even more difficult to measure.[1] This task is further complicated by the need for the Federal Reserve to write rules that are often focused primarily on ensuring the safety and soundness of financial institutions. The benefits of a safe and secure financial system are clear, but they are difficult to quantify. Like other agencies, the Federal Reserve must often rely on information from regulated firms and from other affected parties for information regarding potential costs and benefits of a rulemaking. These parties often cannot quantify costs

[1]GAO Report GAO-12-151, p.19; *See also* p. 36.

or benefits and, even where that is possible, may not have the incentive to provide that information or may be concerned about providing that information, which may reveal confidential business practices, in a public rulemaking.

2. Provide your agency's current and future plans to regularly review and, when appropriate, modify regulations to improve their effectiveness while reducing compliance burdens. Please include a description of actions your agency has taken, or plans to take, to streamline regulations; for example, the Consumer Financial Protection Bureau's "Know Before You Owe" effort drastically simplifies mortgage and student loan disclosure requirements. Also note statutory impediments, if any, that prevent your agency from streamlining any duplicative or inefficient rules under your purview.

The Federal Reserve has for many years had a policy of conducting a zero-based review of each of its regulations on a periodic basis--typically every five years. The purpose of this review is to update each rule, reduce unnecessary burden, and streamline regulatory requirements based on our experience in implementing the rule and where permitted by the authorizing statutory provisions that motivated the rule. In selecting regulations to be reviewed, we consider such factors as the length of time since the last evaluation of the regulation, our experience in administering the rule, the continued need for the rule, the type and number of complaints and suggestions received, the direct and indirect burdens imposed by the regulation, and the need to simplify or clarify the regulation and eliminate duplication.

With respect to rules adopted as a result of the Dodd-Frank Act, the Federal Reserve will review the impact of Dodd-Frank Act regulations once they are completed and firms have had a reasonable opportunity to implement these provisions. As part of this review, we will consider ways to reduce burdens that appear over time in the Dodd-Frank rules.

3. Provide details of how your agency encourages public participation in the rulemaking process, including through administrative procedures, public accessibility, and informal supervisory policies and procedures.

We are committed to soliciting and considering the comments of the public in the rulemaking process. We believe strongly that public participation in the rulemaking process improves our ability to identify and resolve issues raised by our regulatory proposals. During the proposal stage, we specifically seek comment from the public on the benefits and costs of our proposed approach, as well as on alternative approaches to our proposal. The Federal Reserve has long followed the practice of providing the public a minimum of 60 days to comment on all significant rulemaking proposals, with longer periods permitted for especially complex or significant proposals, such as our capital rules and our recent proposal on enhanced prudential standards. We also have extended our comment periods when it appears that the public interest would be served by allowing additional time for comment. Recently, for example, we extended the comment periods for our risk retention and Volcker rule proposals. We also favor seeking public comment on significant statements of regulatory guidance, and typically invite the public

to comment on major statements of supervisory guidance, such as our guidance regarding incentive compensation and stress tests.

We also encourage public participation in the rulemaking process by making it easy for the public to find, review, and submit comments on any proposal that we have opened for comment and published in the *Federal Register*. All of these proposals can be found on our public website and at Regulations.gov. Public comments are accepted electronically and by mail. The rules and proposed rules that the Board expects to issue during the next six months are summarized in the Unified Agenda (also known as the Semiannual Regulatory Agenda), which is published twice each year in the Federal Register and posted on the Board's website. To ensure the public has sufficient notice of our rulemaking efforts under the Dodd-Frank Act, we also have published an anticipated schedule of these proposals on our website.

Moreover, Federal Reserve staff have participated in more than 300 meetings with outside parties and their representatives, including community and consumer groups, in connection with rulemakings required by the Dodd-Frank Act. To promote transparency, we post on our website a memorandum describing the attendees and subjects covered in any meetings involving non-governmental participants at which Dodd-Frank Act rulemakings are discussed. These summaries are posted on the Federal Reserve Board's website on a weekly basis.

To further transparency in the rulemaking process, the Federal Reserve also posts on its website all comments received on each proposed rule. Comments can also be viewed in person at the Board between 9:00 a.m. and 5:00 p.m. weekdays and can be obtained by formal request under the Freedom of Information Act. In addition, we make available to the public our examination manuals, supervisory letters, transaction approvals (and denials) and other matters of interest to the public related to our regulatory responsibilities.

4. Provide details of how your agency addresses the unique challenges facing smaller institutions when dealing with regulatory compliance, including any related advisory committees your agency may have or other opportunities for small institutions to be heard by your agency. Please also detail how your agency responds to concerns raised by small institutions.

The Federal Reserve has paid particular attention to reducing regulatory burden on community banking organizations. We have taken a number of steps to remain aware of the challenges faced by and the burdens of our proposals on community banks. For example, the Federal Reserve has established a set of community depository institution advisory councils at each of the 12 Federal Reserve banks for the purpose of gathering input from community depository organizations on ways to reduce regulatory burden and improve the efficiency of our supervision as well as to collect information about the economy from the perspective of community organizations throughout the nation. A representative from each of these 12 advisory councils serves on a national Community Depository Institution Advisory Council that meets semiannually with the Board of Governors to bring together the ideas of all the advisory groups.

The Board of Governors has also established a committee of Board members for the purpose of reviewing all regulatory matters from the perspective of community depository organizations. These reviews are intended to find ways to reduce the burden on community depository organizations from our regulatory policies without reducing the effectiveness of those policies in improving the safety and soundness of depository organizations of all sizes.

In addition, we are taking steps to reduce the burden on community depository organizations from our regulatory initiatives. For example, in its recent rulemaking proposals, the Federal Reserve has proposed and adopted streamlined approaches that reduce burden on community depository organizations that engage in fewer risky activities and have less complex structures. The Federal Reserve has also begun to separately and prominently identify which rulemakings apply to community depository organizations and what portions of particular rulemaking proposals are germane to community depository organizations, thereby reducing the attention community depository organizations pay to the many rulemaking proposals that are currently pending.

Moreover, for every new rule, the Board conducts an assessment and takes account of the potential impact that the rule may have on small businesses, small governmental jurisdictions, and small organizations as required under the Regulatory Flexibility Act ("RFA") (5 U.S.C. 601 et seq.). The Board prepares and makes available for public comment in the *Federal Register* an initial regulatory flexibility analysis for any rule that will have a significant economic impact on a substantial number of small entities. A final regulatory flexibility analysis is prepared for every rule that may have a significant economic impact on a substantial number of small entities and published in the *Federal Register*.

5. Describe how regulatory interagency coordination has improved since the creation of the Financial Stability Oversight Council established by the Wall Street Reform Act. Provide specifics of how coordination has helped, either formally or informally, in your rulemaking process.

The Dodd-Frank Act requires that the financial regulatory agencies consult or coordinate action on rulemakings under that Act in many cases. The Federal Reserve has actively worked with the other agencies in these joint and consultative rulemakings, both through direct contact with other agencies and through the FSOC. The FSOC has provided a ready forum for interagency consultation on rulemakings. These consultations have helped highlight the interaction between rulemakings under development by the Board and the broader set of rulemakings by other agencies under the Dodd-Frank Act, as well as improving our understanding of the interplay between proposed policy alternatives and existing regulation. The interagency consultation process has included staff discussions during the initial policy development stage, sharing of draft studies and regulatory text in the interim phases, and dialogue among agency principals in the advanced stages of several rulemakings.

The Federal Reserve also consults regularly with its fellow bank regulatory agencies on matters that might affect institutions supervised by the other bank regulatory agencies as well as on

matters of common interest where a single regulatory approach across banking organizations of different charters would reduce compliance burden and risk. Members of the Board as well as staff at senior levels have established working associations with their peers at other agencies that include regular meetings to discuss policies of common interest and applicability. These many avenues of consultation at multiple levels increase the coordination and consistency of regulation across a banking industry that has multiple regulators and charters. We have expanded these channels to include regular consultation with the SEC, CFTC, CFPB and other agencies as changes in law have caused our spheres of regulatory responsibility to increasingly overlap.

FEDERAL HOUSING FINANCE AGENCY
Office of the Director

January 11, 2012

The Honorable Tim Johnson
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510-6075

Dear Chairman Johnson:

In response to your letter regarding the rulemaking process at the Federal Housing Finance Agency (FHFA), I am providing the attached memorandum from our Office of General Counsel to address questions presented. As you know, FHFA has a more discreet and focused mission in overseeing the secondary market than other financial regulators. At the same time, FHFA takes seriously both the content and impact of its rulemaking activities. I would note that FHFA is subject to and adheres to the Administrative Procedure Act in all its rulemaking activity. The Act contemplates clear presentations to permit robust public participation, input of data from varieties of sources and requires that the agency act with a reasonable basis for any interpretations of law. Additionally, FHFA submits its regulations to Congress for congressional review pursuant to the Congressional Review Act.

I hope the attached memorandum addresses fully the specifics and spirit of your inquiry. Please contact me if you have any questions or your staff may contact Alfred Pollard, General Counsel, at 202 414 3788.

Yours truly,

Edward J. DeMarco
Acting Director

1700 G Street, N.W., Washington, D.C. 20552-0003 • 202-414-3800 • 202-414-3823 (fax)

MEMORANDUM

TO: Edward J. DeMarco
Acting Director

FROM: Alfred M. Pollard
General Counsel

RE: Chairman Johnson's Inquiry Regarding Regulation

DATE: January 11, 2012

Below, please find the issues presented by Chairman Johnson's letter to the Federal Housing Finance Agency (FHFA) and the Agency's response. As you know, regulation at FHFA is a collaborative effort of examiners in the field, senior staff addressing functional areas of supervision and the legal department. Adherence to government wide policies guide FHFA's actions and FHFA addresses cost and benefit analysis in the context of the large firms under its regulation and goes further to seek the impact not only of regulations, but implementation by the regulated entities on smaller institutions.

1. FHFA's rulemaking process; economic inputs; costs and benefits.

The Federal Housing Finance Agency rulemaking process, as with other federal agencies, involves a review of existing law and regulation to determine if a regulation is needed. If so, the Office of General Counsel works with appropriate offices within FHFA to determine the outlines and coverage of a proposal and what form of rulemaking under the Administrative Procedure Act (APA) would best serve the Agency's mandate and the need for public comment. Therefore, the Agency may undertake an Advanced Notice of Proposed Rulemaking, where greater public input would benefit the formulation of a rule, a Notice of Proposed Rulemaking, where the Agency has sufficient information— legal and economic— to make a proposal for public comment or an Interim Final Rule, where circumstances exist such that the APA authorizes early action by the Agency in its safety and soundness role with a subsequent comment period to determine if some modification may be required. FHFA's statutory mandates are very clear and detailed and many rulemakings reflect the language of the statute on matters upon which Congress already has opined. Comments taken in such a case are mainly focused on implementation of the congressional directive.

The economic analysis we undertake on new rules varies depending on the nature of the rule and our statutory requirements. As a safety and soundness regulator, FHFA is especially conscious of the potential effect that its rules might have on the stability of the marketplace. Indeed, many of the agency's rules are issued with the intent of preventing catastrophic costs that might accompany a financial crisis. Such rules do not lend themselves to statistical cost-benefit analysis, as they are targeted at low probability, high potential cost events. Estimates of the benefits of such regulations would be very sensitive to choices among possible assumptions and

parameters, for which the statistical basis would be nominal at best. Nevertheless, within the scope of such flexibility as the particular statutory mandate permits, FHFA does not move forward with a rule unless the perceived benefits clearly outweigh the perceived costs. Where comments relating to economic impact are received, they are carefully considered by offices within the Agency with expertise in these matters.

For the most part, FHFA has not encountered significant challenges in collecting the data needed to conduct economic analysis of rulemaking. The regulated entities respond to our requests for data and information relating to their activities and operations, and FHFA's statute empowers it to require such data and information by order where necessary. In addition, FHFA has ready access to available economic, financial and industry data that may be needed to conduct economic analysis. However, in some cases information is simply not available or cannot be obtained without imposing a significant cost on market participants. In those cases, FHFA carefully weighs those costs before proceeding with data requirements.

2. FHFA's plans to review regulations for increased effectiveness and reduced burden.

FHFA conducts ongoing reviews of regulations for their effectiveness or burden as part of its continuous supervision program. That is, the Agency has many examiners located at its regulated entities and they provide important input regarding the operation of existing laws, regulations or operational processes.

FHFA is undertaking a form of review for effectiveness and burden as it consolidates and revises regulations from its predecessor entities, the Federal Housing Finance Board and the Office of Federal Housing Enterprise Oversight, and an office of Department of Housing and Urban Development. FHFA is reviewing each of those prior regulations and is readopting some, modifying some and rescinding others.

Additionally, a plan for regular future review has been developed in line with Executive Order 13579, "Regulation and Independent Regulatory Agencies" (July 11, 2011). FHFA published a proposed program in the Federal Register (76 FR 59066, Sept. 23, 2011) and solicited public comment. Under the proposed plan, FHFA would review each of its regulations at least once every five years against a number of factors, including whether marketplace developments or technological evolution have rendered existing regulations inefficient or outmoded, whether plain-language improvements can be made, whether consolidation or elimination of regulations would facilitate compliance or supervision, and whether alternatives to existing regulations would be less intrusive or more efficient in achieving the supervisory purposes. Having received no adverse comments on the proposed plan, FHFA will implement it as proposed.

3. How FHFA encourages public participation in the rulemaking process.

Beyond the APA provisions for public comment, FHFA makes extensive efforts to inform our rulemaking by actively reaching out to stakeholders, including the public, industry participants and community groups. FHFA executives routinely make public appearances at industry events and gatherings to gain insights and hear opinions from outside groups. FHFA also meets with these groups to encourage involvement from various sources. As one example, this year FHFA

held its annual leadership meeting in Washington, D.C. for the Federal Home Loan Bank Advisory Councils. This two-day meeting included a number of the advisory council chairs and several of the Home Loan Bank community investment officers. Attendees were encouraged to share ideas with FHFA concerning such issues as support by the Home Loan Banks, Fannie Mae and Freddie Mac for small and multifamily projects and revisions to the regulation on Community Investment Cash Advance programs.

FHFA's recently enhanced website is another avenue by which the public is informed. Every regulatory proposal promulgated by FHFA is posted on our website and all public responses can be found on the website as well. Finally, pursuant to the Housing and Economic Recovery Act of 2008 (HERA), FHFA established an Office of Ombudsman, the mission of which is to receive concerns from our regulated entities and others about FHFA's supervisory activities, including its regulations.

4. How FHFA addresses the challenges facing smaller institutions.

While FHFA does not regulate smaller institutions, it does seek information about market impact of its regulations. All of its regulated entities are wholesale financial institutions ranging in size from $30 billion in consolidated total assets (the smaller Home Loan Banks) to over $3 trillion (Fannie Mae). Consequently, FHFA's assessments of regulatory burden and supervisory effectiveness are made against the background of the resources and infrastructure available to some of the largest financial institutions in the country.

FHFA recognizes that many of the institutions with whom our regulated entities do business are smaller institutions and FHFA is mindful of Enterprise and Home Loan Bank procedures and processes that can affect such firms. This is not a direct product of regulation, but rather business practices of the regulated entities and FHFA works with the regulated entities on such matters. For example, HERA required FHFA to develop a system of affordable housing goals applicable to the mortgage purchase programs of the Federal Home Loan Banks comparable to the system applicable to the Enterprises. In developing that system, FHFA was cognizant that the Banks' smaller mortgage purchase programs are provided as a service to smaller financial institution members who for practical reasons have less access to other wholesale markets, such as the securitization markets. FHFA did not want to impose a regulatory burden that might cause those smaller mortgage purchase programs to be insufficiently profitable to be maintained, which could result in their being shut down and no longer available to those smaller members. Consequently, FHFA established a size threshold that a Bank's mortgage purchase program would have to reach before the affordable housing goals would be activated; 12 CFR 1281.11.

5. Improvement in regulatory interagency coordination since the creation of FSOC.

The Dodd Frank Wall Street Reform and Consumer Protection Act requires the Financial Stability Oversight Council (FSOC) to coordinate certain rulemakings by its member agencies and to be consulted on others. At other points, the Act requires federal financial supervisory agencies to issue rules jointly, in coordination or in consultation with other agencies. Overall, these various types of interagency coordination requirements have helped inform the rulemaking process and provide for the sharing of views from different agency perspectives. FSOC provides

a useful venue to encourage coordination and has recently undertaken an initiative to ensure that its member agencies are informed about rulemaking activities of other members.

From FHFA's perspective, one area of potential improvement would be to include FHFA as an observer member of the Federal Financial Institutions Examination Council.

cfpb Consumer Financial Protection Bureau

1801 L Street NW, Washington, DC 20036

January 3, 2012

Dear Chairman Johnson,

Thank you for your recent letter concerning the importance of taking a smart approach to financial services regulation. The Consumer Financial Protection Bureau wholeheartedly agrees that financial services regulation should take careful account of benefits and costs, involve consideration of a wide range of factors for each rule, and promote public participation. These ingredients help to ensure the overall goal of developing federal regulations that provide robust safeguards for consumers and clear guidance for financial services providers without imposing undue burdens.

The Dodd-Frank Act specifically embeds these objectives into the mission of the Bureau, and we are committed to their execution. As an evidence-based agency, the Bureau will develop and issue regulations where there is a strong justification for doing so, work with stakeholders—including industry—to implement them, and monitor them to ensure their effectiveness over time.

The Dodd-Frank Act and several other statutes give the Bureau specific guidance on these processes. For instance, statutory requirements direct us to analyze certain benefits, costs, and impacts in the course of our rulemakings, take comments from the public, consult with small businesses on certain rules and with appropriate federal agencies at certain stages of the rulemaking process, and conduct a thorough assessment of the effectiveness of significant regulations within five years of their issuance.

The Bureau is working diligently to conduct careful evidence-based analysis and solicit widespread public participation in our rulemaking processes. We are incorporating those disciplines into our current rulemaking initiatives—which focus both on reforming the mortgage markets and implementing other statutory requirements mandated by the Dodd-Frank Act. We will also refine these rulemaking procedures over time.

Notably, we are also working to streamline and simplify regulations that we have inherited from other federal agencies. We believe our efforts will enhance consumer protections and facilitate compliance and fair competition among financial services providers.

As you requested, we have provided details on our processes and current and planned initiatives in the attachment. Please let us know if additional information would be helpful.

Sincerely,

Raj Date
Special Advisor to the Secretary of the Treasury
on the Consumer Financial Protection Bureau

1. **Provide a detailed description of your agency's rulemaking process, including the variety of economic impact factors considered in your rulemaking. Please note to what degree you consider the benefits from your rulemaking, including providing certainty to the marketplace and preventing catastrophic costs from a financial crisis. Also describe any difficulties you may have in quantifying benefits and costs, as well as any challenges you may face in collecting the data necessary to conduct economic analysis of your rulemaking.**

Like most Federal agencies, the CFPB is subject to the rulemaking requirements of the Administrative Procedure Act[1] ("APA"). Under the APA, the CFPB is required, subject to certain exceptions, to publish proposed and final rules in the Federal Register and give interested persons the opportunity to participate in the rulemaking process by submitting written comments. The APA also requires the CFPB respond to any significant issues raised during the public comment process.

In addition, Section 1022(b) of the Dodd-Frank Act requires the CFPB, when prescribing certain rules under the Federal consumer financial laws, to consider: (1) the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from such rule; (2) the impact of proposed rules on insured depository institutions or credit unions with total assets of $10 billion or less, as described in section 1026; (3) the impact on consumers in rural areas. The Regulatory Flexibility Act also separately requires the Bureau to consider potential economic impacts on small entities, including small financial services providers.

Under Section 1022 and the Regulatory Flexibility Act, the CFPB strives to identify the significant sources of benefits, costs and impacts of a potential regulation to consumers and regulated entities. The types of benefits, costs, and impacts that are significant will depend on the type of regulation. We will gather the best, most reliable information available about these factors consistent with statutory deadlines, practical constraints, the Paperwork Reduction Act, and due consideration of the benefits and costs of potential new data collections. We assess benefits, costs, and impacts quantitatively where we can gather quantitative information consistent with these constraints. In other cases we provide careful qualitative assessments and explain why quantitative data are unavailable.

2. **Provide your agency's current and future plans to regularly review and, when appropriate, modify regulations to improve their effectiveness while reducing compliance burdens. Please include a description of actions your agency has taken, or plans to take to streamline regulations; for example, the Consumer Financial Protection Bureau's "Know Before You Owe" efforts drastically simplifies mortgage and student loan disclosure requirements. Also note statutory impediments, if any, that prevent your agency from streamlining any duplicative or inefficient rules under your purview.**

We are building the CFPB to be smart, effective, and balanced. We have hired PhD economists, financial analysts, industry experts, regulatory lawyers, and examiners to help develop our expertise in consumer financial markets. We are constantly reaching out to industry and consumers to learn more. Our actions will be deliberate and evidence-based, and where possible, we will work to improve the effectiveness of our regulations while reducing unwarranted compliance burdens.

In addition, Section 1022 of the Dodd-Frank Act specifically requires the Bureau to assess the effectiveness of significant regulations within five years of their issuance. The Bureau must publish a report on the

[1] 5 U.S.C. §§ 551-559.

assessment, which must address, among other relevant factors, the effectiveness of the rule in meeting the purposes and objectives of the Act and the specific goals stated by the Bureau. In addition, the Regulatory Flexibility Act requires the Bureau to review regulations that have a significant economic impact on a substantial number of small entities every ten years.

We have taken our first step toward retrospective review through a number of targeted initiatives to streamline and improve the effectiveness of existing regulations. We just inherited over a dozen regulations from other federal agencies, many of which have been on the books for years. Changes in technology, market practices, and the legal landscape may have caused some of these rules to become obsolete, unnecessary, redundant, or counterproductive. Earlier this month, the Bureau initiated a targeted review of these rules in search of ways to update and streamline them.[2] The Bureau has invited public input to propose specific rules as priority candidates for streamlining. We are also inviting suggestions to make it easier for providers to comply with existing rules.

As you mentioned in your letter, another effort is our *Know Before You Owe* (*KBYO*) initiative to integrate federal mortgage loan disclosures that are required under the Truth in Lending Act and Real Estate Settlement Procedures Act. This project, which was mandated by the Dodd-Frank Act, provides an opportunity to both improve the usefulness of information provided to consumers and reduce the paperwork burden on industry from having to complete multiple overlapping forms. As discussed further below, we have also used this project as an opportunity to experiment with new forms of public outreach to ensure broad-based public participation and input.

We have recently launched other *Know Before You Owe* initiatives on student loans (in partnership with the Department of Education) and credit card agreements to evaluate ways of providing to consumers and industry critical information on prices, risks, and credit terms in formats that are easy to understand and use. We plan to pilot a prototype credit card agreement with one or more issuers, including Pentagon Federal Credit Union, one of the largest credit unions in the country, to get on-the-ground feedback.

3. **Provide details of how your agency encourages public participation in the rulemaking process, including through administrative procedures, public accessibility, and informal supervisory policies and procedures.**

The CFPB uses the same APA rulemaking processes that apply to most other federal agencies to ensure that the public has an opportunity to comment on all proposed rules. We have also gone beyond the APA's requirements to solicit public input in anticipation of potential rulemakings such as a rule to define "larger participants."

Moreover, the CFPB is one of only three agencies subject to the small business advocacy panel requirements of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"). Under SBREFA, the CFPB is required to convene a panel—consisting of personnel of the Bureau, the Office of Management and Budget, and the Chief Counsel for Advocacy of the Small Business Administration—prior to issuing certain proposed rules. The panel then gathers input from small entity representatives selected in consultation with the SBA on the potential impacts and alternatives to the anticipated regulation. The CFPB then drafts a report on behalf of the panel summarizing the comments of the small entity representatives and the panel's findings.

[2] 76 Fed. Reg. 7582 (Dec. 5, 2011).

In addition, the Bureau uses its website to facilitate public participation. For example, as part of the *Know Before You Owe* mortgage initiative the Bureau posted prototype forms on its website when it began testing the forms with consumers and industry members, rather than waiting until issuance of a formal rulemaking proposal. Over the last six months, we have received approximately 25,000 comments through several revisions of the prototypes.

We are constantly looking for ways to improve input. For example, at the end of the 90-day comment period on our streamlining initiative, commenters will have an additional 30 days to respond to other commenters.

Finally, we are engaging in extensive outreach to stakeholders through roundtables, speeches, and other direct contact. For example, we have met with community bankers in all 50 states and with credit unions across the country. As described in more detail above, the Bureau is also preparing to consult specifically with small businesses on certain rulemakings as required by the Small Business Regulatory Enforcement Fairness Act.

4. **Provide details of how your agency addresses the unique challenges facing smaller institutions when dealing with regulatory compliance, including any related advisory committees your agency may have or other opportunities for small institutions to be heard by your agency. Please also detail how your agency responds to concerns raised by small institutions.**

Small financial institutions may be burdened disproportionately by compliance requirements, as compared to larger institutions. We are working to reduce existing regulatory burdens where feasible and to avoid imposing unwarranted new regulatory burdens. For example, we have met extensively with small community banks and credit unions, and have established an office of Small Business, Community Banks, and Credit Unions at the Bureau. Small financial institutions have also had to compete on a playing field that has tilted too often toward less closely regulated nonbank competitors. Having a director in place is critical to the Bureau's efforts to level that playing field.

First, we have a large variety of tools besides regulations to fulfill our mandates—including supervision, guidance, enforcement, consumer education, research, and reporting. We believe that there will likely be cases where one or more of these tools would better address a problem, with fewer burdens, than would a new regulation.

Second, section 1022 of the Dodd-Frank Act requires the Bureau to consider the potential benefits and costs of proposed rules to consumers and covered persons, including small lenders. The statute specifically requires the Bureau to consider impacts on banks and credit unions with assets of $10 billion or less, as described in section 1026, in addition to impacts on rural consumers and on access to consumer financial products and services.

Third, under the Regulatory Flexibility Act (RFA), we must assess the potential economic impacts of proposed rules on small businesses, non-profits, and local governments. Unless the Bureau can certify that it does not expect a proposed rule to have a significant economic impact on a substantial number of these small entities, the Bureau must convene a panel to consult with affected businesses. The Bureau is preparing to convene a panel to consult with small financial services providers regarding the *Know Before You Owe* mortgage project this spring.

The Bureau must also provide an impact analysis when proposing the rule. A second impact analysis is then required when finalizing the rule. The analyses must consider the effectiveness and compliance burdens of a proposal versus other alternatives and any potential impacts on the cost of credit for small businesses.

Finally, through the Bureau's streamlining initiative, the Bureau is seeking comment on potentially expanding exemptions for disclosure and reporting rules for entities that make very small numbers of loans.

5. **Describe how regulatory interagency coordination has improved since the creation of the Financial Stability Oversight Council established by the Wall Street Reform Act. Provide specifics of how coordination has helped, either formally or informally, in your rulemaking process.**

Title I of the Dodd-Frank Act created the Financial Stability Oversight Council (FSOC) to, among other things, identify potential threats to the financial stability of the United States and to make recommendations to primary functionary regulatory agencies to apply certain supervisory standards. Title I imposes a broad responsibility on the FSOC to facilitate interagency coordination by facilitating information sharing and coordination among its member agencies and other federal and state agencies on the development of financial services policy, rulemaking, examinations, reporting requirements, and enforcement actions. The Director of the Bureau will have a seat on the FSOC.

The Bureau began consulting with appropriate agencies in connection with various rules that it issued in July 2011, and has continued to consult with regard to other rulemaking projects. Section 1022 of the Dodd-Frank Act requires the Bureau to consult with federal banking regulators and other appropriate agencies regarding the consistency of proposed rules with the prudential, market, or systematic objectives administered by such agencies. We have found these consultations helpful as we consider the impacts of potential rules on different types of financial services providers.

National Credit Union Administration

Office of the Chairman

December 21, 2011

The Honorable Tim Johnson
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, DC 20510

Re: Financial Rulemaking

Dear Chairman Johnson:

This letter responds to your correspondence of November 9, 2011, that asks the independent financial services regulatory agencies to provide you with information about our rulemaking processes. As noted in your letter, I wholeheartedly agree with you that financial services regulators need to craft "clear, effective, and robust financial regulations that build a stronger foundation for sustainable economic growth."

The National Credit Union Administration (NCUA) is very much committed to working with Congress to ensure the development of smart, strong, clear, and efficient financial services regulations. In fact, I believe that NCUA has an exemplary record of balancing prudent and robust safety-and-soundness rules with responsible regulatory relief. For example, I am pleased to report that under our current rulemaking process, NCUA conducts regular reviews of all of our rules on a rolling three-year basis, invites public participation through multiple channels, facilitates coordination with other agencies, and integrates financial and economic data into our safety-and-soundness rulemakings.

Moreover, under my recently announced Regulatory Modernization Initiative, NCUA is publicizing our commitment to *effective*, not excessive, regulation. Where current rules are ineffective or overly burdensome, NCUA will eliminate or streamline those regulations. Where new risks arise and current rules become outdated or insufficient, NCUA will modernize those regulations or draft new rules.

The following analysis describes in greater detail NCUA's current rulemaking and regulatory review process, our plan to advance the Regulatory Modernization Initiative, our efforts to assist small credit unions, and our interagency outreach efforts.

Regulatory Review and Modernization

NCUA's rules, policies, and procedures for promulgating regulations are set out in Part 791 of our regulations and Interpretive Ruling and Policy Statement (IRPS) 87-2 (as amended by IRPS 03-2), which the public may view on NCUA's website.[1] NCUA has a well-established regulatory review policy, a copy of which is attached. Since 1987, NCUA has adhered to this policy to ensure that, among other things, our regulations impose only the minimum required burdens on credit unions, consumers, and the public. This policy also requires us to issue final rules only after full public participation in the rulemaking process.

In accordance with this policy, NCUA reviews all of our existing regulations every three years. To accomplish this review, our Office of General Counsel maintains a rolling review schedule that identifies one-third of existing regulations under review each year. We update and post this schedule on NCUA's website at the beginning of each year and invite the public to comment on all regulations proposed for review.

Through this review process, NCUA, for the past 24 years, has regularly updated, clarified, and simplified existing regulations, as well as eliminated redundant and unnecessary provisions.

Additionally, I recently announced to the credit union industry a comprehensive Regulatory Modernization Initiative.[2] This initiative builds upon NCUA's ongoing efforts to review and improve our regulations.

For rules that NCUA can control, the Regulatory Modernization Initiative will ensure that those rules are in sync with the modern marketplace, clearly written, and targeted to areas of risk. NCUA's new regulatory focus will target risky behaviors in credit unions, rather than require all credit unions to comply with a rule irrespective of their level of risk.

In the last several years, we have experienced an unprecedented number of market innovations that have the unintended consequence of syndicating the inherent risks in financial products. At the same time, many credit unions have grown more complex and now engage in more sophisticated risk-taking ventures. While this increased sophistication is generally a positive trend for the credit union industry, it also presents a significant challenge to the regulator. When adopted by many credit unions, a new product, service, tool, or relationship can post significant risks to the National Credit Union Share Insurance Fund (NCUSIF).

In order to keep credit unions safe and sound while relieving regulatory burdens, the Regulatory Modernization Initiative will balance two key principles: first, safety and soundness, by strengthening regulations necessary to protect the 91 million credit union members and the NCUSIF; and second, regulatory relief, by eliminating or revising regulations that limit flexibility and growth.

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[1] 12 C.F.R. §791.8; IRPS 87-2, 52 Fed. Reg. 35231 (Sept. 18, 1987); IRPS 03-2, 63 Fed. Reg. 31949 (May 29, 2003). NCUA regulations are listed section-by-section on NCUA's website at http://www.ncua.gov/Legal/Regs/Pages/Regulations.aspx.

[2] My speech with further details on the Regulatory Modernization Initiative is available online at http://www.ncua.gov/News/Documents/SP20110919Matz.pdf.

In the coming months, NCUA is planning to modernize three significant rules in an effort to strengthen safety and soundness by addressing marketplace practices and emerging risks:

- *Loan Participation Protection.* The modernized rule will require originators of risky loans that sell participation interests in those loans to a widespread group of credit unions to retain some of the original loan risk on their balance sheets. It will also require purchasers of participation loans to perform due diligence on an ongoing basis.

- *Credit Union Service Organization Risk Transparency.* NCUA is the only prudential Federal Financial Institution Examination Council (FFIEC) agency without statutory examination and enforcement authority over vendors of federally insured financial institutions. To the extent permitted by law, this modernized rule will provide a clearer picture to NCUA and to credit unions of the off-balance sheet risks at credit union-owned organizations that sell high-risk services to credit unions.

- *Interest Rate Risk Management.* The modernized rule will require certain credit unions to have an appropriate policy to manage interest rate risk. Targeting only those credit unions with sufficient size and/or interest rate risk that poses a threat to the NCUSIF, the proposed rule applies to only 43 percent of all credit unions, yet covers more than 96 percent of all credit union assets. For affected credit unions, the proposed rule allows each credit union to customize the interest rate risk policy to the credit union's risk profile.

Balancing these three safety-and-soundness rules is an equal number of regulatory relief measures:

- *Community Development Revolving Loan Fund Access.* On October 27, 2011, the NCUA Board approved a final rule to improve access to the Community Development Revolving Loan Fund. The rule reduces costs, eliminates outdated processes, expands transparency, and creates a streamlined user-friendly rule.

- *Regulatory Flexibility.* On December 15, 2011, the NCUA Board approved a proposed rule for public comment that will extend provisions of NCUA's Regulatory Flexibility (RegFlex) program to all federal credit unions. It currently applies to only credit unions that have CAMEL codes of 1 or 2.

- *Derivatives as an Interest Rate Risk Hedge.* To provide a new tool for credit unions subject to the Interest Rate Risk Management Rule, NCUA is considering a proposal to allow qualified credit unions to use simple derivatives as an interest rate risk hedge.
- *Zero-Risk Weights.* NCUA is considering a proposed rule that would allow credit unions to assign a zero-risk weight to most U.S. Treasury securities.

Finally, your letter asks whether any statutory impediments prevent NCUA from streamlining any duplicative or inefficient rules. At this time, we have no statutory impediments to revising or eliminating rules. Pending legislative proposals to impose a rulemaking moratorium could, however, have the unintended consequence of temporarily preventing agencies from proceeding

with rulemakings designed to eliminate outdated regulations, streamline existing standards, and make current rules more user friendly.

Integrating Financial Data

NCUA collects and produces volumes of publicly available data to report on the financial conditions of each federally insured credit union. Each quarter, NCUA aggregates this financial data. The NCUA Board uses this data, together with data compiled by NCUA's Chief Economist and other public and confidential sources, to identify current and emerging risks, and to formulate policy. In addition, NCUA collects and aggregates private financial data obtained through examinations and other confidential supervisory contacts.

The NCUA Board carefully considers all relevant data during the rulemaking process. Whenever appropriate, we also summarize and discuss available public data in the preambles to our proposed and final rules.

Further, many of NCUA's rulemakings involve improving credit union risk-management processes or increasing the regulatory information to facilitate identification of potential risks. These rules typically have limited and generally indirect impacts on lending, investment, and job growth. These rules also often have important—but difficult to quantify—benefits in terms of reducing losses to the credit union system. The cost-benefit analysis for most NCUA rules will therefore have a degree of uncertainty related to both effects on economic activity, which are generally very small, and benefits, which sometimes accrue years in the future and are generally characterized as avoided negative outcomes, such as failures of credit unions and losses to the NCUSIF.

Inviting Public Participation

NCUA encourages members of the public to contact us and recommend that the agency develop a regulation, or revise or repeal an existing regulation.[3]

Twice each year, NCUA adopts an agenda of proposed regulations that we have issued or expect to issue, and currently effective regulations that we have under review. We also include information on regulations finalized since publication of the last agenda. NCUA voluntarily submits each semiannual agenda to the Office of Management and Budget for inclusion in the "Unified Agenda of Federal Regulations" usually published in the *Federal Register* in April and October of each year.

Before proposing a significant regulatory change, NCUA Board members and staff personally discuss rulemaking plans with stakeholders, through speeches, webinars, town hall summits, and meetings with credit union and trade association officials. Information obtained from these public interactions helps determine the scope, structure, and timing of NCUA rulemaking priorities.

[3] 12 C.F.R. §791.8(c)

Once the NCUA Board acts on a rule, to encourage public participation in the rulemaking process, we publish all proposed and final rules in the *Federal Register* and make these rulemakings available online at www.regulations.gov and www.ncua.gov. The public may submit comments on our proposed regulations via both websites, too.

Additionally, as a matter of policy, NCUA generally gives the public at least 60 days to comment on a proposed regulation. If the comment period is less than 60 days, NCUA publishes a statement in the *Federal Register* explaining the change.

Working with Small Credit Unions

NCUA formed the Office of Small Credit Union Initiatives (OSCUI) to foster small credit union development and the ability of these financial institutions to deliver financial services effectively, facilitate expansion of credit union services through new charters and field of membership expansions, and coordinate efforts with third-party organizations to improve the viability and successful operation of credit unions.[4] OSCUI's programs for small credit unions include direct assistance (one-on-one consulting); online and in-person training; and partnerships with government, non-profit, and private organizations.

OSCUI also administers the Community Development Revolving Loan Fund (CDRLF), which provides financial assistance (grants and loans) to support low-income designated credit unions serving low-income communities with low-interest loans or deposits. As noted above, the NCUA Board recently issued a final rule to improve the CDRLF Program.[5] The final rule— which represented a complete overhaul of the former regulation—removed outdated processes, enhanced transparency, and created a more user-friendly and streamlined regulation, in order to improve access to financial assistance for small credit unions. The modernized rule will provide additional flexibility and relief to credit unions applying for CDRLF program assistance.

Interagency Outreach and Coordination

To help restore integrity in the markets and strengthen the public's trust in the financial system, NCUA coordinates with the other federal financial regulators as a member of the Financial Stability Oversight Council (FSOC), a broad interagency body developing regulations and supervision strategies to ensure the safety and soundness of entities that are systemically significant to the U.S. financial system. During the past year, NCUA and the other FSOC regulators have, working together, made significant progress toward implementing the initiatives mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, including issuing a number of important studies, proposed and final rules, as well as establishing a framework for identifying and analyzing emerging risks. I believe the FSOC is a critical institution that will have an important role in the financial system's stability for many years to come.

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[4] NCUA's OSCUI recently launched the first in a series of free videos designed to ensure small credit unions are informed of the NCUA resources available to help them succeed. This first introductory video provides an overview of OSCUI's role within NCUA and highlights the programs available for small credit unions. The first introductory video is available online at http://www.ncua.gov/News/Pages/NW20111206OSCUIVideo.aspx.

[5] 76 Fed. Reg. 67583 (Nov. 2, 2011).

NCUA also benefits from other opportunities for interagency coordination and cooperation. To minimize inconsistent or overlapping regulatory requirements across agencies, NCUA coordinates with other federal financial regulators as a member of FFIEC, which I currently chair. FFIEC is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions.[6]

Additionally, NCUA's Office of Consumer Protection coordinates with the Consumer Financial Protection Bureau (CFPB) on a routine basis, which is essential given the respective enforcement roles of NCUA and CFPB. Currently, only three federally insured credit unions exceed the $10 billion threshold to receive consumer compliance examinations from CFPB. NCUA and/or state regulators continue to examine the remaining 7,176 federally insured credit unions subject to all CFPB regulations.

Moreover, NCUA facilitates a unique relationship with the National Association of State Credit Union Supervisors (NASCUS), based on our ability to exchange confidential supervisory information regulator-to-regulator. NCUA's coordination with NASCUS empowers federal and state regulators to share examination experiences and work collaboratively to strengthen the regulatory framework.

In sum, NCUA remains committed to ensuring our regulations are reasonable, innovative, and cost-effective, and to encouraging full and robust public participation in the rulemaking process. Please feel free to contact me with any questions or comments.

Sincerely,

Debbie Matz
Chairman

Enclosure

[6] FFIEC members include NCUA, the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC). In 2006, the State Liaison Committee (SLC) Chairman became a voting member of the FFIEC. The SLC consists of representatives from the Conference of State Bank Supervisors (CSBS), the American Council of State Savings Supervisors (ACSSS), and the National Association of State Credit Union Supervisors (NASCUS). In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) eliminated the Office of Thrift Supervision (OTS) and added the Director of the Consumer Financial Protection Bureau (CFPB) as a member of the FFIEC.

INTERPRETIVE RULING AND POLICY STATEMENT NUMBER 87-2 (as amended by Interpretive Ruling and Policy Statement 03-2)

DEVELOPING AND REVIEWING GOVERNMENT REGULATIONS

I. Statement of Policy and Coverage

It is the policy of NCUA to ensure that its regulations:
-- impose only minimum required burdens on credit unions, consumers, and the public;
-- are appropriate for the size of the financial institutions regulated by NCUA;
-- are issued only after full public participation in the rule making process; and
-- are clear and understandable.

II. Procedures for the Development of Regulations

1. Proposed Regulations

The Office of General Counsel (OGC) will oversee the development of regulations. Input on regulations will be obtained from other NCUA offices when appropriate, OGC will prepare a draft of the proposed regulation for submission to the NCUA Board for approval. The proposed regulation will then be published in the Federal Register and other appropriate publications,

2. Initial Regulatory Flexibility Analysis

When NCUA is required by 5 U.S.C. § 553, or any other law, to publish a general notice of proposed rule making for any proposed regulation, NCUA will prepare and make available for public comment an initial regulatory flexibility analysis for any regulation that will have a significant economic impact on a substantial number of small entities. Credit unions having less than ten million dollars in assets will be considered to be small entities. Such analysis will describe the impact of the regulation upon small entities, and will be published in the Federal Register at the time of general notice of proposed rule making for the regulation. A copy of the analysis will be forwarded to the Chief Counsel for Advocacy of the Small Business Administration (SBA). The content of the initial regulatory flexibility analysis will be in accordance with the provisions of 5 U.S.C. § 603. In addition, NCUA staff will consult applicable U.S. Small Business Administration guidance, including The Regulatory Flexibility Act: An Implementation Guide for Federal Agencies, when interpreting and implementing the requirements of the Regulatory Flexibility Act.

3. Compliance With the Paperwork Reduction Act

If a proposed regulation contains an information collection request such as a recordkeeping or reporting requirement that, if adopted, will be imposed upon ten or more persons (including credit unions), the proposed regulation will be sent to the office of Management and Budget (OMB) prior to publication in the Federal Register, OMB will then have 60 days after publication to comment on the information collection request. If OMB thereafter disapproves of the information collection request, the NCUA can override this by a majority vote and certify such override to OMB in the manner described in 44 U.S.C. § 3507(c).

4. Final Regulatory Flexibility Analysis

A final regulatory flexibility analysis will be prepared for all regulations that required the publication of a general notice of proposed rule making and that will have a significant economic impact on a substantial number of small entities. The content of the final regulatory flexibility analysis will be in conformance with 5 U.S.C. § 604. Initial and final regulatory flexibility analyses need not be prepared if the Board certifies that a regulation will not have a significant economic effect on a substantial number of small entities. The certification will be published in the Federal

Register with the final rule, along with a statement providing the factual basis for such certification. A copy of the certification and statement will be provided to the Chief Counsel for Advocacy of the SBA.

5. Final Rule

OGC will prepare a draft final regulation to be presented to the NCUA Board for approval. Following Board approval, the final regulation will be published in the Federal Register and other appropriate publications.

III. Opportunity for Public Participation

A member of the public may recommend that NCUA develop a regulation or revise an existing regulation. A number of methods will be used by NCUA to encourage public participation in the development and review of regulations, including: notifying the public of the status of regulations being reviewed and developed through publication of the semiannual agenda; publication of advance notices of proposed rule making with requests for public comment; the use of questionnaires to solicit information; publication of articles; and by making copies of proposed regulations available to the public.

When any regulation is promulgated which will have a significant economic impact on a substantial number of small entities, the NCUA will assure that small entities have been given an opportunity to participate in the rule making process through the types of methods listed in 5 U.S.C. § 609.

NCUA will continue to solicit public comment on proposed regulations as required by 5 U.S.C. § 553. As a matter of policy, NCUA believes that the public should be given at least 60 days to comment on a proposed regulation. If the comment period is less than 60 days, or is extended beyond 60 days, NCUA will publish a statement in the Federal Register explaining the change.

IV. Review of Existing Regulations

NCUA shall periodically update, clarify and simplify existing regulations and eliminate redundant and unnecessary provisions. 5 U.S.C. § 610 requires that regulations having a significant economic impact on a substantial number of small entities will be reviewed every ten years, As a matter of policy, NCUA will continue with its efforts to review all its existing regulations every three years. To accomplish a review every three years of all regulations, the Office of General Counsel will maintain a rolling review schedule that identifies one-third of existing regulations for review each year and will provide notice to the public of that portion of the regulations under review each year so the public may have an opportunity to comment.

V. Semiannual Agenda

Twice each year, NCUA will adopt an agenda of proposed regulations that the Agency has issued or expects to issue and currently effective regulations that are under NCUA review, Incorporated into the agenda, when necessary, will be the regulatory flexibility agenda required by 5 U.S.C. § 602, Each semiannual agenda will be voluntarily submitted to the Office of Management and Budget for inclusion in the "Unified Agenda of Federal Regulations" published in the Federal Register in April and October of each year.
The semiannual agenda will contain the following: a brief description of the subject area being considered and a summary of the nature of any regulation which NCUA expects to propose or promulgate; the objectives and legal basis for the issuance of the regulation; an approximate schedule for completing action on any regulation for which NCUA has issued a general notice of proposed rulemaking; and the name and number of an NCUA official knowledgeable with respect to each agenda item. The agenda will identify any regulation that the NCUA expects to have a significant economic impact on a substantial number of small entities. When there are proposed regulations listed in the agenda that will have such an impact on small entities, NCUA will endeavor to provide notice of the agenda to small entities in the manner set forth in 5 U.S.C. § 602(c). Where the regulatory flexibility agenda is incorporated into the semiannual agenda, the latter will be transmitted to the Chief Counsel for Advocacy of the SBA for comment.

e-CFR Data is current as of December 20, 2011

Title 12: Banks and Banking
PART 791—RULES OF NCUA BOARD PROCEDURE; PROMULGATION OF NCUA RULES AND REGULATIONS; PUBLIC OBSERVATION OF NCUA BOARD MEETINGS

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Subpart B—Promulgation of NCUA Rules and Regulations

§ 791.7 Scope.

The rules contained in this subpart B pertain to the promulgation of NCUA rules and regulations.

§ 791.8 Promulgation of NCUA rules and regulations.

(a) NCUA's procedures for developing regulations are governed by the Administrative Procedure Act (5 U.S.C. 551 *et seq.*), the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), and NCUA's policies for the promulgation of rules and regulations as set forth in its Interpretive Ruling and Policy Statement 87–2 as amended by Interpretive Ruling and Policy Statement 03–2.

(b) *Proposed rulemaking.* Notices of proposed rulemaking are published in the Federal Register except as specified in paragraph (d) of this section or as otherwise provided by law. A notice of proposed rulemaking may also be identified as a "request for comments" or as a "proposed rule." The notice will include:

(1) A statement of the nature of the rulemaking proceedings;

(2) Reference to the authority under which the rule is proposed;

(3) Either the terms or substance of the proposed rule or a description of the subjects and issues involved; and

(4) A statement of the effect of the proposed rule on state-chartered federally-insured credit unions.

(c) *Public participation.* After publication of notice of proposed rulemaking, interested persons will be afforded the opportunity to participate in the making of the rule through the submission of written data, views, or arguments, delivered within the time prescribed in the notice of proposed rulemaking, to the Secretary, NCUA Board, 1775 Duke Street, Alexandria, VA 22314–3428. Interested persons may also petition the Board for the issuance, amendment, or repeal of any rule by mailing such petition to the Secretary of the Board at the address given in this section.

(d) *Exceptions to notice.* The following are not subject to the notice requirement contained in paragraph (b) of this section:

(1) Matters relating to agency management or personnel or to public property, loans, grants, benefits, or contracts;

(2) When persons subject to the proposed rule are named and either personally served or otherwise have actual notice thereof in accordance with law;

(3) Interpretive rules, general statements of policy, or rules of agency organization, procedure or practice, unless notice or hearing is required by statute; and

(4) If the Board, for good cause, finds (and incorporates the finding and a brief statement therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest, unless notice or hearing is required by statute.

(e) *Effective dates.* No substantive rule issued by NCUA shall be effective less than 30 days after its publication in theFederal Register,except that this requirement may not apply to:

(1) Rules which grant or recognize an exemption or relieve a restriction;

(2) Interpretive rules and statements of policy; or

(3) Any substantive rule which the Board makes effective at an earlier date upon good cause found and published with such rule.

(f) NCUA has an Office of Management and Budget (OMB) control number for rulemakings containing an information collection within the meaning of the Paperwork Reduction Act (44 U.S.C. 3501). A list of OMB control numbers is available to the public for review online at *http://www.RegInfo.gov.*

[53 FR 29647, Aug. 8, 1988, as amended at 59 FR 36041, July 15, 1994; 68 FR 31952, May 29, 2003; 75 FR 34623, June 18, 2010]

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